# LIVE ARTICLES ON SURETYSHIP

No. I

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ON

# SURETYSHIP

## No. 1

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## FOREWORD

There are so many things which the man at the home office has always known that it is sometimes hard for him to realize that to the man in the field some of these old familiar problems are coming up for the first time. Sometimes this very familiarity makes it difficult for the man at the home office to explain to a new man what has so thoroughly become a part of his own experience.

The series of articles presented herewith was originally published in serial form in THE WEEKLY UNDERWRITER for the purpose of instructing the men in the field with the technical points of the surety business with which they should be familiar. In book form it is believed that these articles will be found useful both to the man in the field and to the man at the home office. As a book of reference these articles will be found practical and instructive. The publishers bespeak for this book the hearty welcome which it deserves at the hands of the public, at the same time extending their thanks to the contributors who have made this publication possible.

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# DEPOSITORY BONDS.

## Legal and Moral Aspects of Underwriting—What the Agent Should Know About Them.

*By E. King Wilson, Attorney, and Alexander Coulter, Manager Public Official and Depository Department of the Fidelity and Deposit Company of Maryland.*

A depository bond is a bond given by a banking institution to secure a deposit of money, either public or private, and is conditioned, in substance, to honor, when presented, all checks drawn on the deposit. Bonds of this kind may be divided into two classes; those bonds which are required by law, and those bonds which are matters of private contract. The former class, which may be designated as statutory depository bonds, includes all bonds securing State, county or city funds; all bonds securing money deposited into court; all bonds securing money coming into the hands of trustees and receivers appointed by courts, such as bankrupt funds, and all bonds securing private funds coming into the hands of public officers, such as Indian funds. The latter class, which may be designated as private depository bonds, includes all bonds required by private persons, either individuals, firms or corporations, to secure deposits of private funds or of public funds, for which the persons requiring the bonds may be personally liable. It will thus be seen that a statutory depository bond may protect private funds and that a private depository bond may protect public funds.

By far the greater part of depository bonds executed by surety companies consists of bonds executed pursuant to some statutory requirement. However, there has, in late years, sprung up a considerable demand for private depository bonds, particularly in favor of concerns which, for business reasons, desire to make deposits of reserve or surplus funds in various sections of the country remote from their home offices.

A deposit of money in bank creates, as a general proposition, the relation of debtor and creditor, whether the funds deposited be public or private. It follows that the obligation which a surety assumes under a depository bond is strictly a financial or credit guarantee. The questions, therefore, which confront the underwriter are: Is the bank applying for a bond an acceptable risk, and if so, how much credit can be extended to it? In answering these questions the underwriter applies many of

the principles which govern the extension of credit in ordinary mercantile transactions, in addition to those principles which are peculiar to the underwriting of depository bonds.

### POINTS FOR CONSIDERATION.

Some of the points which are given consideration in connection with depository bonds are:

1. The financial standing of the applicant bank.
2. The character and standing in the community of the officers and directors of the bank.
3. Nature of the deposits.
4. The locality of the bank and local conditions surrounding the bank.
5. The probability, in case of bank failure, of recovering a portion of the loss from the assets of the bank.
6. The relation which the total deposit to be made under the bond bears to the penalty of the bond.
7. The peculiar features, in the case of a statutory bond, of the laws applicable to such bond.
8. The term for which the bond is desired.
9. The protection which the bank has in the way of burglary insurance and fidelity bonds on its officers.
10. Indemnity agreements covering depository bonds.
11. Collateral security covering depository bonds.
12. The surrender of collateral securities.

It is impracticable for an underwriter, either personally or through his agents, to examine the applicant bank, even if the premium would justify the expense of such an examination. so that the underwriter must necessarily rely upon the published financial statements of the bank and the reports of examinations made by national bank examiners, in case of a national bank, and by State bank examiners in case of a State bank or trust company, supplemented by such information as he may obtain through his local agents. For the purpose of underwriting, it must be assumed that a bank's statement is correct.

### THE BANK STATEMENT.

A bank statement is merely a summary of the financial condition of the bank, as shown by its books, setting forth on one side the items which make up its resources, and on the other the items which make up its liabilities. Among the resources are included loans and discounts, overdrafts, secured and unsecured, bank building, other real estate. furniture and fixtures, cash in bank, and cash in reserve and other banks. Among the liabilities are included capital stock, surplus and undivided profits. bills payable, notes and bills rediscounted, and deposits, including

time, demand, savings, etc. The underwriter considers these items separately and collectively, in order to determine whether or not they are in the right proportion. If a bank presents a statement, the items of which stand in the proper relation to one another, it is a good risk, provided it is not objectionable for any of the reasons which will be considered later.

The underwriter first of all must be satisfied that the funds of the bank are invested in "quick" or "liquid" assets—that is, assets which can be easily converted into cash to meet the daily demands of depositors or to meet the obligations of the bank, in case it should close its doors. Real estate and mortgage loans are not reckoned as "quick" assets. For this reason a bank with a relatively large investment in real estate or mortgage securities is not considered a good risk. Large real estate holdings not only show "slow" assets, but also indicate that the bank was not able to realize the sums loaned upon the security of real estate and was compelled to take it over to protect its interests—a fact which reflects more or less unfavorably upon the business ability of the men in charge.

The item of furniture and fixtures plays no part whatever in the case of very large banks, for they are often carried for the nominal sum of one dollar. However, in small banks, with very small surplus funds, there has been a tendency to put the value of the furniture and fixtures at a large figure, to that extent increasing the surplus.

It is imperative that a bank shall have on hand ready cash with which to meet the daily demands of its depositors. So important is this matter that national banks and State banks in nearly all the States are required by law to carry a reserve equal to a fixed per cent. of their deposits. This cash reserve can be carried in the bank itself or a part of it can be carried in other banks known as reserve agents. If a bank's statement shows that its cash reserve is below the proper amount, the bank is a questionable risk. The bank should be positively declined if a comparison of its statements shows that it is a constant offender in this respect.

The first items on the side of liabilities are capital, surplus and undivided profits. The capital is the fund contributed by the stockholders. The surplus represents either a fund paid in by the stockholders at the time of organization, or a fund set apart out of the earnings, or it may consist partly of each. The undivided profits represent the profit and loss account of the bank. From this account are taken current losses, expenses and dividends as well as the amounts which are carried to the surplus fund. While these three items are carried as liabilities, apparently in the same class with deposits, they are not in reality, as is well known, on an equality with deposits, In liquidating a

bank, depositors are paid before anything is distributed to stockholders. Therefore the capital, surplus and undivided profits constitute the fund which stands between depositors and loss. The larger the surplus of a bank, the greater the amount of loss which can be sustained and the greater the shrinkage that can occur in its assets without impairment of its capital and the resultant closing of its doors. There is no definite rule as to the relation which the capital and surplus, or either, shall bear to deposits. The national banking act is silent on the subject, except that it does provide the minimum capital for a bank in cities of a certain size, and that before declaring a dividend it shall carry one-tenth of its net earnings for the preceding half year to its surplus fund, until the same shall equal 20 per cent. of its capital. It would seem that a combined statement of all national banks, made up from their reports upon some date taken at random, would present the items of capital, surplus and deposits in the relation in which they should stand to one another in a very strong bank. If we take the combined statement as of November 26, 1912, we find that the capital and surplus fund together were about 28 per cent. of deposits, that the capital alone was about 16 per cent. of deposits, and that the surplus alone was about 12 per cent. of deposits. In other words, in a bank in which these ratios exist there could be losses or shrinkages in its assets in excess of 28 per cent. of the deposit without endangering depositors. With these figures as an arbitrary standard, a bank which shows larger or smaller percentages will be considered correspondingly strong or weak.

### BORROWED MONEY.

Bills payable and notes and bills rediscounted show what money the bank has borrowed. Borrowing by banks is regarded as perfectly legitimate. However, very few laws expressly authorize banks to borrow money. Text book writers say that a bank has implied powers to borrow, and even to pledge its assets as security for sums borrowed by it. If a bank has excessive bills payable, it may be taken for granted that its best paper has been put up as collateral and that the least valuable paper has been retained by it, thus weakening materially the bank's condition and rendering more probable the closing of its doors in case of large demands by depositors. Where a comparison of a bank's statements shows that it is an habitual borrower in large amounts, even at periods of the year when good banking does not recognize the necessity of borrowing, it may be safely said that the bank cannot realize upon its paper sufficient sums to pay checks of its depositors.

A large line of depositors shows the confidence of the public, and, what is vastly more important, furnishes to the bank the

means of making its profits. While this is true as a general proposition, still the deposits should, as before stated, be in the proper proportion to the capital and surplus.

Not only is it necessary to analyze the applicant bank's latest statement, but also to compare its statements extending over a considerable period of time. Any decrease in the surplus fund indicates that the bank has sustained losses which it could not pay out of current earnings, while any increase in the line of deposits indicates that the confidence of the public is not lessening, and furthermore, that its earning capacity is being augmented. Not only will a comparison show whether or not a bank is making money, as shown by its reserves, whether or not its deposits are increasing or decreasing, whether or not it is a constant borrower, and whether or not its real estate holdings are increasing or decreasing, but such comparison may serve a useful purpose in other ways. Some time since an applicant bank presented its statement to a surety company, with a request for the execution of a depository bond on its behalf. The underwriter, upon an analysis of the statement, was not favorably impressed, and upon comparing statements he found that an item in the last statement, amounting to many thousands of dollars, was identical to a penny with the same item in a former statement, though it was an item ordinarily subject to constant changes. The underwriter concluded that this was more than a coincidence and that it could be explained only upon the theory that the bank was falsifying its accounts to conceal its true condition. The risk was declined, and in less than two months the bank closed its doors.

An important factor is the personnel of the management of the applicant bank and the standing in the community of its officers and directors as substantial, conservative business men. On this point the local agent is supposed to furnish the necessary information. The estimate of the public is usually reflected in the size of the individual deposits, which, as a rule, can be taken as a safe guide.

### THE BAD RISK.

It goes without saying that a bank which makes large loans, without good marketable collateral, to its officers and directors, or to business ventures which they are promoting, or even to well-established enterprises in which they are interested, is necessarily a bad risk. In other words, an underwriter gives wide berth to a bank, which he is satisfied is run for the personal convenience and benefit of its officers and directors.

As indicated by the above summary of the points to be considered by the underwriter of depository bonds, there are elements, other than the bank's financial strength and the stand-

ing of its officers and directors, which enter into the underwriting of the bonds under discussion.

While, as before stated, a large line of deposits shows, as a general proposition, the confidence of the public, still the nature of the deposits must be taken into consideration. A bank with very large deposits of public funds, that is as much as 50 per cent. of the total deposits of the bank, is not regarded favorably by underwriters. A defeat at the polls of the party in power, or even of the faction in power, may result in heavy withdrawals of such funds and the closing of the bank's doors.

The location of the bank often plays a very important part in the question of determining the advisability of writing a depository bond. In certain sections of the country banks make their loans upon the security of commodities peculiar to these sections, such as cotton, grain and lumber. If a commodity of this kind should be very high in the market or show an inflated value, then a bank with large loans secured by such commodity, without an ample margin, is highly undesirable.

In depository underwriting, just as in all cases of insurance, the premiums are based on experience over a period of time, that is, on the total premium receipts, as compared to losses and expenses, and upon the probability that the same ratio will continue. In case of loss under depository bonds, unlike insurance generally, the surety makes, except in rare instances, a recovery from the assets of the failed depository. As this recovery has averaged 75 per cent., the premiums on depository bonds are fixed upon the basis of a 75 per cent. recovery. It is therefore to the question of possible recovery in case of loss that the underwriter's attention must also be directed.

Should the deposit be equal to or less than the penalty of the bond, the surety experiences no difficulty, in the case of either a statutory or private bond, for, upon paying the amount of the deposit, it receives an assignment of, or becomes subrogated to, the depositor's rights to dividends out of the bank's assets. In Oklahoma, however, after the passage of the bank guaranty law, it was decided[1] that the surety on a depository bond securing State funds was not only not subrogated to the State's right to be paid in full out of the guaranty fund, but was not entitled even to dividends out of the assets of the failed bank. As a result of this decision surety companies were compelled to discontinue the writing of depository bonds covering public funds in that State. Later the law was amended so as to give a surety a right to dividends out of the failed depository. In Mississippi there is a law similar to the law of Oklahoma before it was amended. This law has been construed by surety companies to

[1]Columbia Bank and Trust Co. vs. United States Fidelity and Guaranty Co., 126 Pac. 556.

deprive a surety on a public depository bond of any share in the dividends of a failed depository. Therefore depository bonds in Mississippi are on the prohibited list with most underwriters. Several of the States which have bank guaranty laws expressly provide that deposits, which are otherwise secured, cannot participate in the guaranty fund, but are entitled to dividends out of the assets of the bank.

### EXCESS DEPOSITS.

Should, however, the penalty of the bond be less than the deposits secured thereby, a difficult question arises in the case of statutory bonds, but not in the case of private bonds. In the latter case the matter of a deposit in excess of the bond, as well as other objectionable features, is covered by the express terms of the surety's bond. Without such an express provision covering the excess deposit, the same principle of law applies to statutory as to private depository bonds, and that is, that the surety is not subrogated to the obligee's rights to dividends until the depositor shall have been paid in full. So that, if the deposit should be double the bond, and if the bank should pay out only 50 per cent. to depositors, there would be a total loss to the surety. Very recently a surety company was compelled to pay a loss under a depository bond running to a public body in Louisiana, the penalty of the bond being less than the deposit. The public body, obligee in the bond, assigned to the surety company at the time of payment, the dividends out of the bank's assets upon a sum equal to the penalty of the bond. The highest court of the State, applying the mentioned principle of law as to subrogation, held that there was no consideration for the assignment and that it was therefore unenforceable.[2] In a recent Tennessee case[3] a bond running to a city expressly provided that upon payment of a loss the surety should be subrogated to all the rights of the obligee against the bank to the amount of such payment, and further required the obligee to execute all papers necessary to secure such rights to the surety. The surety, upon paying the penalty of its bond in part settlement of the obligee's loss, attempted to enforce its supposed rights to dividends on the amount paid by it. The court held that the subrogation contracted for was nothing more than the usual equitable right which it would have had without stipulation and that the clause did not provide for subrogation pro tanto upon paying a part of the obligee's claim.

While in the case of a private bond, the matter of excess deposits is usually covered by a provision of the bond, this is not

[2]Board of Health vs. Teutonia Bank and Trust Co., 68 So. 748.
[3]Knafel vs. Knoxville Bank and Trust Co., 182 S. W. 232.

always possible in the case of statutory bonds. Some laws requiring depository bonds provide that the bonds shall be in form satisfactory to the approving officer, while other laws set out the forms of the bonds, or at least the conditions of the bonds. If an officer, who is authorized to accept a bond in form satisfactory to him, should accept a bond giving the surety a pro tanto right of subrogation, the bond would no doubt be enforced according to its terms. If, however, an officer, whose duty it is to approve a depository bond, the form or condition of which is fixed by law, should approve a bond differing from the statutory form, a different and more difficult question arises. In some of the States it is expressly provided by law that any bond filed under a statute, no matter what its form, will be construed as if executed in the form prescribed. In other States, the courts have disregarded as surplusage any proviso or clause in a statutory bond which gives less protection than the statute requires.[4] If, therefore, an underwriter should receive an application from a bank located in a State in which there was no law or decision on this subject, and should determine that the bank with a broad statutory form of bond would be undersirable, but that it would be desirable with a bond less onerous than the statutory form, he could not, even if assured of the acceptance and approval of the narrower form of bond, execute it with any degree of confidence that it would be enforced according to its terms.

In some States the laws requiring depository bonds provide that deposits shall not be made in a depository in excess of the penalty of the bond, or a certain per cent. thereof, or in excess of a certain per cent. of the capital of the bank, not more, however, than the penalty of the bond. The question arises as to the rights and liabilities of the surety in case of a deposit in excess of the legal amount. In Wisconsin it was decided[5] that an excess deposit did not release the sureties, because sureties on the bond of an officer of a State are presumed to know that it does not contract with them that other public officers will faithfully perform their duties. In New Mexico, in which the same question arose[6] the court, following certain Nebraska decisions, held that the surety was not released by an excess deposit, for the reason that its liability was not increased thereby. Unless the surety, in a case of this kind, should be allowed dividends out of the assets of a bank on the sum paid by it, its liability would be materially increased. Hence it would seem that the effect of the last mentioned decision is to give a surety the dividends on the amount of its payment, in case of an excess deposit.

[4]Forest Township vs. American Bonding Co., 154 N. W. 26 (Mich.)
[5]State vs. Pederson, 114 N. W. 828.
[6]Territory vs. Mills, 120 Pac. 325.

Again, under the laws of some of the States a public body has an absolute right to priority of payment out of the assets of a failed depository. This right is based either upon the theory of sovereign prerogative right in a State or upon the doctrine of trust funds. The law of other States, while recognizing this right of priority of payment, does not allow such priority, except in case of a deposit of public funds without requiring a depository bond pursuant to the depository laws, or in case of an excess deposit in a legally qualified depository. In the event of an excess deposit under these conditions, the surety on the depository bond will recover its pro rata part of the dividends from the assets of the bond, but as the excess deposit will be entitled to priority of payment, the fund out of which the surety will be paid its dividends will be correspondingly decreased. In this connection it may be stated that in the States in which either the State or a county or city is entitled to absolute priority of payment, even when the depository laws are complied with, depository bonds are naturally desirable underwriting propositions, for a surety, upon payment, becomes subrogated to the priorty right of the obligee in the bond. It rarely happens that all the assets of a bank are insufficient to pay such priorities though it is, of course, possible. It may be asked why a depository bond should be required under these circumstances. It is for the reason that the assets of a bank may possibly not be sufficient to pay the priorities, and besides, a public body must have its money available at all times and must not be deprived of the use thereof, until the conversion of the bank's assets into cash and until the passage of an order of distribution determining questions of priority.

A bank may be known to be perfectly solvent to-day. Its condition a few years hence is a matter of conjecture. A vital point, therefore, to be considered is the term of the bond, in other words, the length of time the surety is asked to lend, or more appropriately to sell, its credit. In the case of a private depository bond its term is definitely fixed in the bond itself. This is not always possible with statutory depository bonds. If statutory depository bonds are continuous and if there be no law or valid contractual provision whereby the surety can terminate its liability, they should be written only for the strongest banks. Some laws require the designation of depositories at stated periods, and for definite terms, others are silent on the subject or leave the designation to public officers in charge of the funds to be deposited. Where a law requires designation for a term, qualification under a subsequent designation ends the liability on the old bond, even though there may remain in the

bank a balance of funds deposited during the prior term.[7] Should the bank not be redesignated, the liability of the surety for a balance at the end of the term depends on the wording of the bond. It can be, and usually is, so conditioned that it will remain liable for all funds deposited during the term, though demand be not made therefor until afterward.[8] If a bank with a broad bond of this kind should be continued as a depository after the expiration of the term, without qualification under a new bond, the first withdrawals after the term would be credited against the earliest deposits and not against the deposits made after the term.[9] Therefore, liability on the bond would end as soon as the withdrawals after the terms should equal or exceed the balance on deposit at that time.

On the other hand, a depository bond can be so conditioned that it will be liable only in case the bank should refuse to honor checks drawn on the deposit and presented during the term of the bond. The closing of the bank's doors during the term is a breach of the bond rendering the surety liable, and dispenses with the necessity of presenting a check for the balance on deposit.[10] This form of bond is the most favorable for the surety, for the surety can fix definitely a date at which its liability ends. The burden is put upon the obligee to check out the fund just prior to the end of the term, or to require a new bond.

Inasmuch as a bank may be rendered insolvent through the dishonesty of its officers and employees, or through burglary or hold-up, it is usually required that the officers and employees be covered by bonds, in ample amounts, with good and sufficient sureties, preferably surety companies, and that policies covering burglary and hold-up be carried. The frequency and ease with which automobile bandits have of late raided banks in small towns and secured large sums of money show the necessity for burglary insurance.

### MAKING A RISK GOOD.

If a bank should be declined, as an undesirable risk, for any of the reasons outlined above, the underwriter next turns his attention to devising some plan by which it can be made acceptable, for it is the province of an underwriter not only to pick out bad risks, but also to make bad risks good, whenever possible. The usual method is by demanding either personal indemnity or collateral security, or both. If personal indemnity is given, it is generally the indemnity of the officers and directors of the bank, and occasionally, of some of its stockholders. If the bank is undesirable because its officers and directors are not considered

[7]Fidelity and Deposit Co. vs. Wilkinson County, 69 So. 865 (Miss.).
[8]United States Fidelity and Guaranty Co. vs. City, 67 So. 87 (Fla.).
[9]Board vs. American Loan, 78 N. W. 113 (Minn.).
[10]Talley vs. State, 180 S. W. 330 (Ark.).

conservative business men, then their indemnity does not add much strength, for it may be taken for granted that the affairs of the bank and of its officers and directors are so intermingled, or are pursued so much on the same lines, that the collapse of the bank will be followed by the failure of its officers and directors. However, where the directors are substantial business men and are individually possessed of considerable means, their indemnity can be accepted.

If collateral should be tendered, pursuant to demand therefor, inquiry should be directed as to its ownership. If owned by individuals, and if of such a nature that it can be readily disposed of in the market for cash, it can be accepted with absolute safety. If the collateral is offered by the bank itself out of its own assets, another question arises. It has been generally considered for a number of years that a bank could put up a part of its own assets to secure a surety on a depository bond. The theory upon which the underwriter proceeded was that the bank was simply exchanging a part of its assets for a present deposit of an equivalent amount in cash, and that for that reason no depositor or creditor of the bank could be injured. It was recently held in a Kentucky case[11] that a State banking institution has no implied power to put up a part of its assets as collateral to secure a depositor, even though the deposit should be made upon the condition that the collateral should be given.

In many States the laws governing the designation of depositories provide that a depository shall qualify either by a deposit of collateral or by giving bond. It would seem that in the States in which there are laws of this kind, a bank has authority to put up collateral out of its assets either directly with the depositor or with the surety guaranteeing the deposit.

An indemnity agreement from the officers and directors of a bank, in favor of one of several co-sureties guaranteeing the same deposit, protects only the surety named in the indemnity agreement and not his co-sureties.[12] Likewise collateral put up by the officers and directors with one surety, to protect it, does not inure to the benefit of its co-sureties even upon the same bond. But collateral which is put up by the bank itself, where it can lawfully be done, to indemnify one surety, inures to the benefit of all sureties who are liable for the same deposit, whether they be bound by the same bond or by different bonds, or become sureties at the same time or at different times, and even to the benefit of a surety who, at the time of becoming such, did not know that collateral had been deposited.[13]

When surety companies execute separate bonds covering the same deposit, or one bond in which they limit their liability each

[11]Commercial Bank and Trust Co. vs. Citizen's Trust, 156 S. W. 161.
[12]American Surety vs. Doyle, 63 N. E. 73 (Ohio).

to a fixed sum, they insert, whenever possible, a clause to the effect that in case of loss each surety will pay such a proportion of the loss as the amount for which it binds itself bears to the aggregate amount for which all the sureties are bound. If one of these sureties, under such circumstances, should take collateral from the bank for its protection, such collateral will not inure to the benefit of the other sureties, not even any surplus remaining in the hands of such indemnified surety after paying its entire loss.[13]

A surety on a depository bond, protected by full collateral, may be confronted with some difficult problems in connection therewith, particularly in connection with its surrender. Of course, there can be no difficulty in surrendering collaterial after the term of a depository bond has expired and after the bank has qualified anew or has paid back the deposit with interest. The difficulties arise when a surety on a statutory bond for a term is requested to surrender collateral during the term, upon a showing that all deposits under the bond have been withdrawn, or that a new bond has been filed and approved, or that an order has been passed by a judge or public officer releasing the surety. It goes without saying that the mere withdrawal of the funds does not release the surety or terminate its liability, for the simple reason that additional deposits may be made during the term. If there is no statutory provision for the filing of a new bond or for the passage of an order releasing the surety, it can be said that neither the filing of the new bond nor the order of release will discharge the surety. There are some States in which the law provides that a surety may institute proceedings for its release. Where such laws are in force, the proceedings must be instituted by the surety and not by the bank or a public officer representing the obligee, and the laws must otherwise be strictly complied with. What has just been said as to term bonds applies with equal force as to continuous bonds. Therefore an underwriter, in case of a continuous bond, may be concerned not so much with getting the collateral as with getting rid of it, and he may consider that the trouble and expense incident to the surrender of the collateral will not justify the writing of the bond.

An underwriter, after determining that a bank applying for a depository bond is worthy of credit, next turns his attention to the amount of credit that can be extended. No definite rule can be laid down on this point. Each case depends upon its own facts and circumstances. However, there are fixed limits beyond which conservative underwriters will not go without reinsurance. These limits are approximately 25 per cent. of the combined capital and surplus of a national bank, and 20 per cent. of the combined capital and surplus of a State bank.

[13]Assets Realization Co. vs. American Bonding Co., 102 N. E. 719 (Ohio).

# COURT BONDS

## One of the Most Important Branches of Suretyship.

*By J. O. Lummis, Counselor-at-Law, Superintendent of Underwriting, Judicial Bond Department, Hartford Accident and Indemnity Company.*

Surety companies are sometimes asked by insurance agents why surety bonds cannot be underwritten in the same manner as other lines of insurance. Suretyship is like insurance in that its purpose is to indemnify against loss upon the happening of certain unforeseen events. The underlying theory of the business of suretyship is quite different, however, from that of insurance. This difference is fundamental and must be thoroughly understood by an agent before a proper conception of a surety company's attitude and underwriting principles can be attained. A brief comparison of the two may therefore be helpful before taking up the discussion of court bonds, which particular branch of suretyship is the subject of this article.

An insurance company, though a private corporation formed for profit, is really a medium through which a large number of persons co-operate and pay in a certain sum annually to take care of all their losses, sustained of course by a few, upon the happening of a designated contingency, the theory being that a certain average of losses is bound to occur. For practical purposes we may say that the losses are sure to come, and if borne individually would work great hardship and ruin, while if distributed among the many, the losses fall lightly upon each.

### THE FUNDAMENTAL PRINCIPLE.

The business of a surety company, on the other hand, is to sell to those who are in need of a surety the use of its name and credit for that purpose. The theory is not that if a large amount of business is written the premiums will take care of the losses, but that only those who are able and willing to fulfil their obligations will be bonded, so that there will be no losses. The premium is considered as the compensation due the company for the use of its name and credit. Insurance assumes that a certain average of losses will occur, and a premium is charged to compensate for those losses; suretyship, on the contrary, assumes that each principal, or person bonded, will perform his obligation, and that there will be no losses. Losses are sustained by surety companies, but they should be only such as against which human prudence and foresight cannot guard.

A surety company does not care to take chances. This principle is fundamental and vital. Any surety underwriter or agent who does not grasp it or who considers it idealistic will not long continue in favor with his company. With this comparison and statement as a preface let us pass to the subject of this article, namely, court bonds, with the hope that a discussion of some of the underwriting and agency features of that class of surety bonds may be of some profit to those occupying the positions of middlemen between companies and applicants.

### TWO GENERAL CLASSES.

Court bonds form one of the most important branches of the surety business and are divided by companies into two general classes, bonds of fiduciaries and court bonds of the credit guarantee class. The division between the two is quite marked. A fiduciary is a person who has the care and custody of another's property, holding it in trust. Fiduciary bonds, however, deal only with fiduciaries who act under the jurisdiction and supervision of a court. They include bonds for administrators, executors, trustees, guardians of minors and incompetents, receivers, assignees, and others in various court proceedings.

The bond of a fiduciary is usually conditioned that the principal will perform the trust in accordance with the principles of law and the direction of the court, and should be considered from the two standpoints of the personality of the applicant and the nature of the position. Guaranteeing as they do that the person bonded will not misappropriate the money or property which may come into his hands, the most important thing to be investigated in the writing of such bonds is what is characterized in various lines of insurance as the moral hazard. It is probably more important here, however, than in any other line. The fiduciary usually has absolute custody of and legal title to the assets of the trust, and the surety company's liability may be said to be limited only by the size of the estate. The fiduciary is not only charged with the duties of a custodian, but in addition has the responsibility of properly performing the trust in accordance with the established rules of law and by interpreting and executing certain directions or orders of the court. Many losses are sustained by surety companies because of criminal misappropriations by persons bonded in these positions, but a surprisingly large number are sustained by improvident acts or omissions, which, while they are illegal, are not necessarily criminal. If the applicant is a person of financial responsibility, he either pays for his mistakes himself or is obliged to reimburse the surety. To these remarks we may add the obvious statement that the applicant should be of a degree of intelligence and business experience proportionate to the task to be performed. Sum-

marizing the requisites of an applicant from the standpoint of personality, it may be said that he should have a reputation for absolute honesty, of some financial responsibility, and be properly qualified from a standpoint of business experience to perform the necessary duties.

### NATURE OF THE RISK.

A representative of a surety company, having satisfied himself as to the desirability of an applicant from a standpoint of personality, should before committing his company consider the nature of the position, and we may here mention some of the features which should be guarded against. Bonds of executors and administrators are perhaps the most common in this class and need no definition here. In appointing these fiduciaries the statutes and courts require but little of petitioners for appointment beyond a right to participate in the distribution of the estate, if an administrator, or by his nomination by the testator in the will in the case of executors. The bond of the surety is to guarantee to creditors and heirs that the estate will be properly administered. A surety company therefore acts at its peril in such cases,, for it assumes the entire responsibility for any failure on the part of the principal.

Let us then consider briefly some of the inquiries which should be made by agents to properly protect a surety in the acceptance of such business. No bond should be executed for an executor or administrator who is indebted to the estate. The theory of law is that immediately on his acceptance of the trust, the amount of his debt becomes and is considered so much cash in his hands for which either he or his surety must account. We hardly need remark that surety companies are opposed to assuming any such financial obligation. even though the applicant may appear to be able to pay the debt. Neither should any bond be signed for an administrator or executor who intends to conduct a business that may be left by the decedent, whether authorized to do so by court or not. These fiduciaries are merely court officers appointed to collect and conserve for final distribution the assets of the estate. They and their sureties will be held liable for losses incurred in the operation of the business, as both creditors and heirs are entitled to have the assets applied as they were at the time of the decedent's death without diminution.

### OPPORTUNITIES FOR DEFALCATION.

Another important consideration is the fact that in conducting a business the opportunities for the principal to commit defalcations and irregularities are greatly increased. A third important consideration is the retention of an attorney by the fiduciary. If applicants are not thoroughly acquainted with court proceed-

ings, the employment of an attorney should always be required before the bond is signed. In fact, most companies insist on this in every case. The standing of an applicant's attorney is an important element in estimating the desirability of the business.

Closely related to the foregoing bonds and frequently growing out of estates in which executors or administrators have been bonded are bonds required of trustees, guardians, curators, committees and conservators. In the case of trustees we will only consider such trusts as are created by will or deed, limiting it to trustees of expressed trusts acting under the jurisdiction of a court of chancery. Bonds for trustees are usually required because of the provisions of a will or such instrument setting aside certain funds or property so that the income from the same may be applied or paid to persons during the remainder of their natural lives, to persons until they arrive at a certain age, or for the use of certain persons under various conditions.

### LONG TERM BONDS.

A guardian is a person appointed by a probate court to manage the estate of a minor and to act for him in all business matters until he arrives at lawful age. Persons appointed to manage the estates of incompetent persons are called committees, conservators, curators, the term varying in different States. The remarks just made with reference to the underwriting of bonds for executors and administrators apply with equal pertinency to bonds for trustees, guardians, committees, conservators and curators. But greater care should be exercised with respect to the writing of these last mentioned classes, for the reason that they are as a rule long term bonds and in addition require the investment of the trust funds, whereas the duties of executors and administrators should only be to collect and distribute. The life of such bonds, if not determined definitely by law or by the will, can be approximated by the present ages of the beneficiaries. Inquiry should always be made about this feature, as it has an important bearing on the extent of the surety's liability. When fiduciaries continue to act in these capacities over periods of many years, the opportunities for committing and concealing irregularities and defalcations are almost unlimited. Applicants for such bonds should be measured by the very highest standards. As a further safeguard it has become an almost universal rule for surety companies not to write these long term bonds without exacting joint control. By this is meant that the funds of the estate shall be so deposited in bank that no withdrawals can be made by the fiduciary without the countersignature of a representative of the surety company, and that the securities of the estate be deposited in a double locked safe deposit box, to which access can only be had when the fiduciary and the com-

pany's representative are both present. With respect to the question of investments, we might mention that most States provide by statute what securities are proper for the investment of funds by trustees and guardians. This feature, however, need not be given much consideration when the bond is executed, as it is a matter which properly comes after the writing of the bond. It is, of course, to the interest of the surety to follow and see that the investments are proper and legal ones.

### BONDS FOR RECEIVERS.

Receivers are persons appointed by courts to take possession of and preserve the property of insolvents, or of property which is the subject of litigation, in order that it may be kept secure from waste or dissipation until final disposition of it is directed by the court. Bonds for such persons are in frequent demand, and included in the general class are receivers and trustees in bankruptcy; receivers appointed by both State and Federal courts in various proceedings, such as receivers of banks, trust companies, railroads, public utility, commercial or industrial corporations, as well as masters, trustees and commissioners appointed to make sale of real estate or personal property. The personality of the applicant is naturally the important thing to be considered in the writing of bonds of this nature. He should be thoroughly competent to perform the duties required by the appointment and in addition should be of unquestioned integrity and of some financial responsibility. The qualifications of the applicant should be commensurate with the size and importance of the receivership. A conservative man, however, with large experience in business affairs, advised by an able attorney, presents a very acceptable risk to surety companies.

### CREDIT GUARANTEES.

We now come to the other portion of court bonds, which we have mentioned as bonds of the credit guarantee class. These bonds are given by litigants and guarantee in effect that the principal, if unsuccessful in the suit in which the bond is given, will satisfy the judgment of the court, or will respond in damages if his suit was wrongfully brought. They include, among others, supersedeas, appeal, attachment, injunction and replevin bonds; costs bonds, garnishment bonds, bonds to release an attachment or to dissolve an injunction; bonds to release ships in admiralty suits or property seized by process of law; as well as bonds to indemnify sheriffs or marshals in executing writs for litigants. The obligation of the surety on one of these bonds is to guarantee the credit of the principal. The financial standing of the applicant is therefore the important thing to be considered, although the moral hazard should never be overlooked. No such bond

should be issued until a most careful investigation has established the fact that the applicant is amply able to protect the bond. The comparison most frequently used is to say that the signing of a bond of this nature amounts to the same thing as endorsing the applicant's note for a like amount. Collateral security in the shape of cash or quick marketable securities is usually required by surety companies on bonds of this kind, which requirement is only waived where the applicant is very dependable and his statement shows his assets to be worth many times the amount of the bond.

Some of these bonds are more hazardous than others, but they are all very dangerous. Space will not permit of an explanation of the particular hazard of each. Each application presents a delicate problem in itself, and complete information about the parties and the circumstances surrounding the suit is necessary for its proper consideration. It must not be inferred, however, that surety companies care to speculate on or forecast the probable outcome of any legal controversy. As stated before, a surety company is not paid to take chances. When a bond of this kind is written it should be assumed that the principal will lose his suit, but even so, the proposition is a safe one. In the case of appeal bonds and quite a few others the applicant has already received an adverse decision in one court, which fact is most significant. Many applications for bonds of this nature must necessarily be declined. Both agents and applicants are frequently displeased and cannot always understand the reason, implying that the attitude of the company, if based on the theory of suretyship as we have endeavored to describe it here, is only a subterfuge. A moment's reflection, however, should convince an agent that a conservative policy by companies in underwriting court bonds of the credit guarantee class is not only justified for the proper safeguarding of their own interests, but that it is the best policy for the good of the general public. If surety bonds of this nature were written on the theory of insurance, litigation would increase immensely. People lacking in moral and financial responsibility would be starting suits of every description, as certain classes are said to thrive on litigation. Premium rates, of course, would advance, but this would probably have no influence other than to embarrass the man with an honest suit.

### A SPLENDID FIELD.

Perhaps the ideas thus far expressed have resulted in discouraging some who are not already thoroughly familiar with this line. We had hoped, however, for opposite results, as the main purpose of the article is to convey a few helpful and stimulating thoughts to the doubtful agent, if not to others, so that he will renew his efforts and reap some of the profits of this very

important branch of the insurance business. Fiduciary and court bonds are needed everywhere, but it can be very truthfully said that opportunity has to knock loud and long at the average agent's door to get him to push for them. It is true that agents cannot create or stimulate a demand for these bonds, with this exception, he may influence some to take the bond of a surety company instead of personal sureties. Personal suretyship is very unsatisfactory and its use is rapidly becoming obsolete. Individuals are becoming quite reluctant to risk their capital for others without compensation, and courts and litigants are equally reluctant to accept personal sureties who may rapidly become situated so as to make the security insufficient. It is the proper sphere of surety companies, and a fair amount of activity on the part of agents should reduce the outworn practice of personal suretyship to a minimum.

Where, then, and how can an agent secure some of this business? A major portion of it is controlled by lawyers, who usually attend to the procuring of such bonds for their clients. The business acquaintance of attorneys should therefore be cultivated and proper preparation made, by what is termed agency organization, before the need for a bond arises, followed by an active solicitation when specific cases come to the knowledge of the agent. Of course, many individuals and corporations attend to the procuring of such bonds themselves; or they will, if asked, convey a preference to their attorney as to the placing of this business. There is a great deal of desirable and profitable business to be had in this line, which should not, as has been the case in a great many localities, be obliged to sell itself.

### RAILROAD RECEIVERSHIPS.

Bonds of receivers of railroads constitute some of the largest surety propositions in the country. Receivers of banks, of public utilities corporations, or of some of the larger industrial and commercial concerns, where the persons appointed are men of prominence and wealth, afford opportunities for a live surety agent, where the annual commission per bond may be expressed in figures of hundreds of dollars. Bonds required in the settlement of the estates of deceased persons of considerable means also present surety opportunities which are particularly attractive to agents. To the preferred risks just mentioned may be added the bonds in medium and smaller amounts, of which there is a surprisingly large number.

There is another consideration which makes court bonds especially attractive from an agent's point of view, and that is that almost without exception they are written for an indefinite term. While the premium is payable annually, the bond runs until the trust is completed. It is quite troublesome and expensive for a

surety company to withdraw from the risk where the laws provide a way of doing so, while in most cases it is impossible for the surety to be changed or relieved until final determination of the suit or proceeding. Agents are therefore not required to sell this business over at each renewal date. Practically all court bonds run for longer than one year and it is not unusual for the life of guardian and trustee bonds to equal or exceed a term of fifteen or twenty years. With annual renewal premiums, the writing of such business is of great value to any agency.

### GOOD FAITH ESSENTIAL.

In closing let us caution the agent as to the absolute good faith which he should bear toward the company which he represents. We mention it because it is a business asset which the agent must have. If a surety company has expressed its confidence in an agent by delegating to him the power to execute bonds and bind the company, he should never, for an instant, violate this confidence reposed in him. He pledges the company's resources on every bond executed, and indifference to its welfare will be promptly noted by its home office underwriters, even though losses may not be actually sustained on the bonds issued. On the other hand, an intelligent and honest use of the powers granted will probably mean the broadening of the same, with the result that the agent may eventually be equipped to compete with the best agencies and to surpass the many smaller ones, whose only thought seems to be to sell a bond and pocket the commissions, regardless of consequences.

In recapitulation let us state that no special qualification is required for one to enter this field of insurance endeavor. A level head combined with absolute integrity is all that is necessary. In considering an application one should insist on being told in plain words who the applicant is and what his duties will be in the position bonded. If all of the facts of a surety proposition are disclosed, in terms free from technical and legal phraseology, most every one should be able to determine whether it is a safe one or not.

## CUSTOM HOUSE BONDS.

### Profitable Line of Surety Business Affording a Varied Experience for the Underwriter—Some Dangerous Lines Pointed Out.

*By Supt. E. E. Kolb, Fidelity Section, Maryland Casualty Co.*

One of the most desirable and profitable lines of bonds written by surety companies is custom house bonds. While the premiums on these bonds are small in proportion to the size of the bond, it is a fact that there have been very few losses, if any, under these bonds in the past, and as a class they impose on a surety company very little hazard, although in some cases there is considerable risk and, in a few exceptional cases, collateral security should be required.

The majority of these bonds are in book form and can only be signed at the Custom House, and any person wishing copies must go to the Custom House and copy same from the records there.

These bonds have been given catalogue numbers by the Treasury Department, and an agent in writing his company with reference to executing any particular custom house bond will do well to mention the catalogue number. A catalogue number presents the proposition to a company more clearly than any attempt on the part of an agent to describe the terms of same.

These bonds can be divided into two general classes, viz.: continuous bonds, on which premiums are collected annually, and bonds known as term bonds, which are given in the majority of cases to cover a single transaction. Term bonds run for a period of from ten days to three years. The large majority of term bonds are cancelled within a period of six months.

#### CONTINUOUS BONDS

can be divided into two general classes: warehousing bonds, and bonds covering the transportation of dutiable merchandise in bond. A great many articles are brought into this country on which the duty is not paid at the time of importation. When the duty is not paid it is necessary that such articles be warehoused, and the owner of a warehouse in which dutiable merchandise is stored must give a license bond known as a warehousing bond, which bond, of course, is conditioned that the warehouse owner will comply with the rules and regulations of the United States Government with reference to the storing of goods on which duty has not been paid, and the bond contains

a provision that articles will not be released except upon a permit from the Government officials. The warehouse company is also liable for the salary of the customs officer in charge of goods in the warehouse. It should be borne in mind that customs officers have complete charge of such warehouses and no entry or withdrawal can be made without their consent.

Some warehouses are owned or leased by the United States Government and some are privately owned and are used for the storage of merchandise owned by the proprietor only. Others are owned by persons engaged in the storing of dutiable merchandise under the warehouse act and are for the use of the public generally. Some warehouses are set apart for the warehousing of certain kinds of articles. For example, warehousing bond, class 5, catalogue No. 3567, is used solely for the storage of imported grain and a great many of these warehouses are found in the Northwest along the Canadian border. The majority of warehouses are located at ports of entry in the United States.

In the second division of continuous bonds are common carriers bonds for the transportation of merchandise in bond, lighters and cartage bonds.

It is well to remember that no one can handle goods brought into this country on which duty has not been paid unless a license bond is given permitting the transportation company or the company owning lighters, barges and teams to transport these goods from place to place.

When goods are imported on which the duty is not paid at once, a railroad company or a steamship company, if it wishes to transport these goods to some place within the United States, across the United States to Canada, or down the coast from one port to another, must give what is known as a common carriers bond.

It also follows that any barge, boat or lighter on which goods are placed to be transported around a harbor or down the coast or from ship to ship in a harbor must give what is termed a lighters bond, and when goods are hauled from a steamship company or pier to a Government or private warehouse to be placed in bond, the owner of the teams hauling these goods must give what is termed a cartage bond.

A common carriers bond for the transportation of merchandise given by a steamship or railroad company is in the amount of $100,000. Lighters and cartmen bonds are in amounts as prescribed by the Government.

### TERM BONDS.

There are a great many bonds in that class which usually cover a single transaction. These bonds run for a period of

from ten days to three years and practically all of them are exceedingly desirable. There are, however, a few important exceptions.

These exceptions are bonds covering the re-delivery for exportation of articles brought into this country free of duty when such articles are to be used here temporarily for the purpose of exhibition.

Another bond of this class is a bond which covers the importation free of duty of animals on which no duty is required if such animals are to be used merely for the purpose of exhibition. On these cases the articles brought in must be exported again within a period of six months.

This particular bond, together with the bond covering the importation of certain animals for exhibition purposes, is considered extremely hazardous and is usually not executed unless companies are fully protected by cash collateral or its equivalent, or unless the principal requiring such a bond is one of large financial responsibility.

Another bond of this nature is one covering the exhibition of works of art. Such articles intended for exhibition and not for sale may be imported free of duty. The point to be clearly established before such a bond is written without collateral is that the article is actually being imported by some large museum of art.

We have mentioned above that certain warehouses are used for the storing of goods on which duty has not been paid. Any importer depositing goods in such a warehouse must give a bond on the goods so deposited. This bond runs for a period of three years, at which time the duty must be paid or the goods must be exported again. The catalogue number of this bond is No. 3577 and it is termed a warehousing bond, but should be distinguished from those warehousing bonds mentioned above which are really license bonds permitting parties to engage in the warehousing business under the warehousing act. This bond is desirable in view of the fact that it is usually desired by importers of some standing and financial responsibility. Care should be taken, however, in writing such bonds on perishable goods. A great deal of merchandise brought into this country and warehoused until a sale is found for same, when the articles are withdrawn from the warehouse and duty paid thereon.

### MISCELLANEOUS BONDS.

I will not attempt to mention separately the various miscellaneous custom house bonds required and the coverage thereunder. Some of the most important are bonds covering vessels loading and unloading at night, bonds covering cargo where the entire cargo is not discharged at the first port of entry, bonds

guaranteeing the production of the necessary documents to complete entry, bonds to produce verified invoice, ten days' and six months' bonds covering the re-delivery of unexamined packages, bonds for the examination and appraisement of machinery, bonds covering the examination of imported teas and those covering the exportation of manufactured articles with benefit of drawback.

When articles are imported it is often the case that the bill of lading does not arrive on the same ship as the article itself. Collectors in releasing such goods usually require a bond known as a collector's indemnity, which bonds guarantees the production of the bill of lading. The risk is not hazardous where the goods are consigned direct to an importer, but where goods are consigned to order, or order notify, the bond is extremely hazardous and the same should never be given without cash collateral. It very often occurs that the bill of lading turns up in the hands of some banking institution and the goods can only be delivered upon the payment for same. As to these bonds it is not necessary to add that an importer of large financial responsibility would hardly make a misrepresentation as to his right to certain goods. It often occurs that goods are sent over not consigned to any particular importer, and even though goods are consigned to order, or order notify, a bond could be executed for an importer of large financial responsibility without exacting collateral.

Another dangerous form of bond in this particular class is one to pay amended duty after the release of goods.

The majority of custom house bonds at large ports of entry are handled by custom house brokers. These brokers are thoroughly familiar with custom house procedure in connection with the bringing of goods into this country, clearing of ships, etc., and for this reason importers for convenience usually designate a custom house broker to take care of their business. Surety companies in the past have been giving custom house brokers a power of attorney to execute bonds on their behalf, and at least 50 per cent. of the custom house bonds are handled in this manner.

## FIDELITY INSURANCE.

### Its History and Gradual Liberalization—How It Is Written and Its Interests Safeguarded.

*By Edward C. Lunt, Vice President, in Charge of the Bonding Department, Fidelity and Casualty Company of New York.*

The first attempt to organize a company to insure the fidelity of employees seems to have been made in London, in 1720, at a place known as "Devil Tavern"—an appropriate birthplace, perhaps, for such a piece of business. The *London Daily Post* made the announcement as follows:

"Whereas, notwithstanding the many excellent laws now in force for punishing hired servants for robbing their masters or mistresses, yet noblemen as well as commoners are daily sufferers; and seldom a session but great numbers are convicted, to the utter ruin of many families, as also a scandal to the Christian religion. This is to give notice that at the request of several housekeepers, books will be opened next Saturday at the Devil Tavern, Charing Cross, at ten o'clock, wherein any person may subscribe, paying 6 pence p. c. for a share called a £1,000 stock; no more shares than 3,000 and the call for the stock not to exceed 10s. p. c. the first year by quarterly payments. This society will insure to all masters and mistresses whatever loss they shall sustain by theft from any servant that is ticketed and registered in this society."

These ambitious promoters seem to have been a century or more ahead of their time, and apparently it was not until 1840 that a company was organized for the writing of fidelity insurance—a company entitled the "Guarantee Society of London." At first the venture was viewed with disfavor by many people otherwise sensible, and objections were made that seem curious now. It was maintained, for example, that the business would not succeed because an employer would not engage a person who could give only the security of a corporation. "The moral security is wanting," was the concrete form of the objection. This view proved to be altogether mistaken, and the business of corporate suretyship has so far expanded in England that about seventy companies are now operating there.

In this country fidelity insurance was late in arriving and slow to take root. As far back as 1853 the New York legislature enacted a law authorizing the formation of fidelity insurance corporations, but apparently no one cared to avail himself of the

enabling act for twenty-two years. In 1875 the Fidelity and Casualty was chartered (under another name), and began operations three years later, becoming thus the first company organized in the United States to issue fidelity bonds. A few years before that, however, the Guarantee Company of North America had been organized in Canada, and began to write fidelity business there as early as 1872.

### FIDELITY INSURANCE AT FIRST EXTREMELY NARROW.

Embarking upon an unknown sea in untried craft, the early fidelity underwriters naturally so planned their virgin voyages that they could scurry back to the shores of cancellation and denial of liability at the first sign of a claim tempest. For a long time only such risks were ordinarily assumed as would now be regarded as the cream of the business; and the insurance provided even as to these gingerly accepted cases was subject to numerous and rigid provisions, stipulations and conditions. As a condition precedent to the issuance of a bond covering an employee, the assured was required to describe minutely the duties of the employee and the conditions under which his work was to be performed, and to stipulate that these duties and conditions would not be changed while the bond remained in force. Since the surety company would not undertake the business unless the safeguards thrown about a bonded person's work were so stringent as to make a loss from dishonesty very unlikely, and since when such a loss did occur it was usually found that the employer had failed to keep effective some of the stipulated safeguards, and had thus forfeited his insurance, it is easy to understand why very unpleasant claim situations continually arose.

A vast amount of litigation over fidelity bonds has been concerned with the legal effect of these preliminary statements made by the assured to the bonding company. Sometimes they have been held to be, in legal parlance, "representations," and in such cases their falsity has not invalidated the bond, unless they have related to facts material to the risk. Sometimes, however, they have been held to be "warranties," and in such cases their falsity has ipso facto nullified the insurance, since any statement warranted by the assured to be true is regarded in law as necessarily material, and the validity of the insurance is conditioned upon its truth.

Besides requiring the employer to make these precise and detailed preliminary statements as to the employee's duties and the supervision of his work, the bonding companies also exacted, in the early days of the business (and to some extent, indeed, up to a few years ago), at each annual renewal date, an "employer's renewal statement"; that is to say, the employer, as a condition precedent to the continuance of the insurance, was

obliged to reaffirm the original statement, to stipulate that the employee's accounts had been checked up to the renewal date and found correct, that the duties and safeguarding conditions would remain the same, etc. This renewal statement was frequently, if not usually, warranted to be true. If a shortage afterward developed, an investigation was likely to show that the man was really in default at the renewal date, though the employer was unaware of the fact; but as the employer had warranted the truth of his statement that the man's accounts at that time were correct, it was at least possible for the bonding company to deny liability on the ground of a breach of warranty. One large and important surety company used to ask its patrons at renewal dates to sign a statement about the person bonded reading in part as follows: "Proper accounts are kept and adequate examinations of his transactions will be made." That last phrase is surely a gem, and must have vastly simplified the work of the company's attorneys (or at least might have done so) whenever a claim was made. All that they had to do was to confront the unhappy employer with his signed renewal statement and point to the word "adequate," and say, with an engaging smile, "Since you admit that your man embezzled some of your money, it is obvious that your 'examinations of his transactions' were not 'adequate.' We must regretfully advise you, accordingly, that there is no activity anywhere."

### APPLIED PROVERBS.

A few years ago a surety company itself suffered a serious default on the part of a member of its staff. The incident suggests two familiar quotations—"If the blind lead the blind, both shall fall into the ditch," and "Who is worse shod than the shoemaker's wife?" The defaulter was bonded by another surety company, and liability was denied because of failure to fulfill the stipulations embodied in the preliminary and renewal statements. This interesting dog-eat-dog episode suggests to our jaundiced mind one of Chaucer's sage observations: "He must have a long spoon that eats with the Devil." If any one objects to our dragging in Mr. Chaucer, on the ground that his authority is too ancient to have weight in the matter, we would cite the analogy of the case of Sagebrush Sam of Catamount Crossroads, Arizona. At a critical point in that case the stranger laid down four aces and scooped in the pot. "This game ain't on the level," protested Sagebrush Sam, at the same time producing a gun with which to emphasize his remarks, "that ain't the hand I dealt ye."

### LIBERALIZED BONDS DUE TO VARIOUS CAUSES.

In the long run no business can survive and prosper unless it serves a useful public purpose and serves it well; and the busi-

ness of providing fidelity insurance to governmental and to private obligees could not possibly have reached its present imposing dimensions—fidelity premiums in the United States in 1916 aggregated not quite nine million dollars (as compared with surety premiums of a little more than seventeen millions)—unless the insurers had radically changed their practices as described above, and had sold to their patrons a product of far greater value than the old-fashioned narrow fidelity instrument. Almost from the beginning the more broad-minded executives saw that they could not permanently do business on the existing illiberal basis, and they began gradually to modify their requirements. While continuing to insist that the assured make and warrant preliminary and renewal statements, they did so less with an idea of standing strictly upon their legal rights in the case of just claims than with the idea of insuring close supervision of the employee's work by the employer, or perhaps of providing themselves with a technical defense against unjust claims. In the case, for example, of the company referred to above as exacting from employers the preposterous renewal statement—a company that has always been noted for the liberality of its treatment of the assured—we are confident that the company never availed itself, in handling a fair claim, of the legal advantage accruing to it because the employer had innocently and without substantial fault failed to make "adequate examinations."

These preliminary statements, and to a less extent renewal statements, are still required by the bonding companies in many cases; but such statements are no longer as a rule warranted or otherwise made a part of the contract, and their falsity would not now, in the absence of fraud, invalidate the bond. It is natural, of course, and reasonable for a surety company, before bonding a man in an important position, to ascertain from the employer what accounting methods are followed in connection with the position; and this information may be conveniently obtained by means of the printed form still called an "employer's statement"; but this is done in connection with, and as an aid to, the underwriting, and not as an essential and possibly invalidating feature of the contract between the parties. In the case of very large and highly organized concerns proper accounting methods would be presumed to exist, and no special inquiry would be made by the surety company as to the conditions under which the bonded persons work.

### BROADENING OUTSIDE INFLUENCES.

It is thus apparent that the change from the early narrow forms of fidelity bonds to the present comprehensive instruments has come about largely from causes operating within the surety

companies; but the change has developed, also, as to two important causes, from influences outside the companies. More and more have the various States, through their insurance departments, fastened watchful eyes upon the operations of the surety companies; and in certain cases changes in bond forms in the direction of broader protection and freedom from confining conditions have been the direct result of the regulatory supervision of these departments. Sometimes the State officials have probably exceeded their real authority in forcing the companies to issue simpler and broader policies; and frequently, no doubt, they have attained their ends more by the pressure of practical considerations than as a matter of admitted and undoubted right. The net effect, however, in any case has been to secure for the public a greater degree of fidelity protection, and to confront the insurers with the problem of procuring from some source sufficient revenue to meet the resultant higher loss ratios.

Another important outside influence promoting the liberalization of fidelity bonds may be found in the nature of the laws enacted by many State legislatures. Very commonly, for example, public officials have been required by statute to furnish bonds conditioned "for the faithful performance" of the duties of their office; and in such cases the surety companies simply wasted good ink and paper if they tried to modify the bald requirement of the statute by interjecting limitations upon their liability. In some States similar laws have been passed in regard to officers of banks, with the same automatic and inescapable broadening effect upon the bonds given in behalf of such officials.

REPRESENTATIONS AND WARRANTIES SOMETIMES CONVERTIBLE TERMS.

It is easy to see from even the brief references above to representations and warranties and their respective legal effcts that the latter are more likely than the former to prove troublesome to the assured and block the path to recovery in the event of claims. While it seems reasonable enough on general principles, when an insurer has assumed a given risk in reliance upon the statements made by the assured and warranted by the latter to be true, for the insurer to hold the assured to his agreement, yet in practice this doctrine of warranty was frequently found to facilitate inequitable results. The average man will not read his bond, and even if he does and thus finds himself "warranting" the truth of certain statements, he rarely realizes how important the phraseology is or understands its legal connotation. Many States, therefore, have passed laws that virtually annihilate the distinction between representations and warranties; and in such States bond forms that have been narrowly drawn in this respect will be automatically broadened by the local statutes.

### BENEVOLENT ATTITUDE OF COURTS.

Even without the aid of statutory law and in reliance solely upon general principles of justice, the courts have ever been prone to temper the invalidating wind to the shorn bond-holding lamb in a closely litigated case. The primary indemnifying purpose of the bond will always loom large in the mind of the court, and will be effectuated, even at the cost of rather ingenious reasoning if necessary, when only such an end would square with the demands of ultimate justice.

### COMPETITION THE CHIEF BROADENING FORCE.

The most important cause of all for the liberalization of fidelity policies has been the aggressive and persistent competition of the bonding companies. Not content with building up their volume through the creation of new business—not a hard thing to do in view of the virgin field and the recognized need of the protection—the companies through their agents have always preferred to make a short cut to their goal by preying upon each other's preserves. Formerly their favorite tool for prying loose a choice line of bonds was rate-cutting; but when, about eight years ago, the organization of the rating bureau put an end (just in the nick of time for some companies) to that form of slow suicide, they concentrated their competing energies upon the point of liberality of bond forms. Such a policy once begun necessarily spread quickly. Every time a broader policy was issued by any company the continued existence of the older and narrowed forms became impracticable. Even if executives could reconcile with their ideas of fair and proper methods of doing business the practice of withholding from old clients concessions made to new ones under the stress of competition, the alert and zealous agents and brokers could be depended upon to see to it that their clients obtained the best and broadest policies anywhere obtainable.

### STANDARD FORM OF FIDELITY BOND.

The wholesome injunction embodied in the Greek proverb Maden agan, "Do nothing too much," was so far ignored by the companies in this matter of broad bond forms that they finally came to err as much in the direction of unnecessary and unwarranted liberality as they had in the early days in the opposite respect; and it ultimately came to be pretty well agreed among executives that a halt should be called. Two or three years ago, accordingly, the matter was brought up before the Surety Association of America, and a certain would-be wag, who tries to be funny in season and out of season (and who sometimes unwittingly succeeds) introduced the following resolution:

"Whereas, The companies are now issuing fidelity bonds of great diversity of protective scope, ranging from instruments

composed of a rivulet of insurance lost in a meadow of limiting conditions to instruments consisting of an ocean of obligation and an attestation clause; and

"Whereas, There would be manifest advantage in the adoption by the companies generally of a standard, uniform fidelity bond form affording all necessary and reasonable protection to the obligee, but conceding, to the extent of a comma or two, the right of the obligor to live—if for no other purpose than to draw the obligee's check;

"Resolved, That a committee of five experienced fidelity underwriters, distinguished for their broadmindedness, but known to be sane, be appointed by the chair to draft a standard fidelity bond form, and to submit the same to the association for fastidious consideration and possible adoption."

That resolution was adopted by the Surety Association; and the committee so appointed, after holding a number of meetings and giving the subject much thought, reported to the association a proposed form of bond. The form was adopted, and is known as the "Surety Association Standard Form of Fidelity Bond." A few years ago this form would have been regarded as extremely liberal, and none of its provisions can reasonably be criticised as in any degree unfair to the assured. Some companies, however, in many cases anyway, are thought to be using still forms of bonds that give the assured more privileges and rights than they really need and surely more than they pay for at current premium rates. Other companies are using the standard form freely, and have no difficulty in procuring its acceptance by the assured.

### SURETY COMPANY AUDITING OF FIDELITY RISKS.

Fidelity bonds are issued by surety companies only when the risk seems satisfactory and at least normal in two fundamental respects: (a) When the person to be bonded is acceptable as to his career and apparent character; (b) When the conditions under which he will perform his trust are such as will not facilitate his betrayal of it.

Condition (a) the surety companies care for by means of their investigations. In connection with condition (b) they will not ordinarily bond a man whose work involves the handling of money and the keeping of books and accounts unless such books and accounts are periodically audited either (and preferably) by some outside expert accountant or at least by some superior officer or board within the given service. Audits of this kind are now a recognized part of good business practice everywhere, and they are made by the best and most efficient concerns in their own interest and without regard to bonding company requirements.

Primarily for their own benefit, but incidentally as well for the benefit of the assured, some surety companies themselves now undertake to audit the accounts of the persons they bond. They do this either through some separate subsidiary or affiliated company or through an auditing department in their own organization. They charge for the fidelity bonds the regular manual rate, and in addition collect a reasonable fee for the auditing service, in accordance with the complexity of the business audited, the number of persons bonded, and other varying conditions. This auditing charge is likely in any event to be much less than the assured would have to pay for similar audits bought in the open market, because the bonding companies perform the service, not for the purpose of making money out of it, but purely as an advantageous and protective incident of their fidelity suretyship. The audits are really a by-product of their bonding operations, furnished to the assured at or near cost; and the companies derive their profit from the transaction in a reduced fidelity loss ratio and in a strengthened hold upon the good will of the assured because of their increased importance and value to them.

This surety company auditing of fidelity risks marks a real and scientific advance in the conduct of the business, and the movement ought to grow. One possible and promising development of the idea would be for a number of companies, not now following the plan or doing so under the obvious disadvantage of a small volume of business, to get together and organize an auditing concern to care for all the audits of the stock-holding companies and also, perhaps, to do a general auditing business for the public at large. The agents of all the participating companies would be encouraged to promote the interests of the auditing subsidiary, and it seems reasonable to suppose that in time a business could thus be built up that would not only be valuable in itself, but would also have beneficial reactions upon the regular underwriting activities of the parent organizations. The idea seems ripe and ready to hand for some organizing genius.

### THE LAST WORD IN BANK INSURANCE.

Up to October, 1915, it was practicable for American banks to obtain from bonding companies in this country only a limited form of fidelity insurance; that is to say, they were able to secure here nothing more than protection against losses due to the dishonesty of a named person up to a stated amount as to each person named. They had long been desirous of securing the same sort of protection, in a large lump amount, as to any and all officers and employees in their service. Wholesale insurance of this nature against losses due to burglary, messenger

hold-ups, etc., was readily obtainable from numerous American companies; and the further demand of the banks was that this kind of protection be embodied in the blanket bond, so that they would have in one instrument complete insurance up to the amount of the bond. The demand for a blanket bond of this kind was finally met by groups of individual underwriters in London, and they soon built up a big bank-bond business in the large cities of the United States.

Without going into the matter of the responsibility of the various London gentlemen who affixed their signatures to the policies referred to, and without intending in any way to reflect upon their character and business integrity, one may nevertheless reasonably conclude that an average banker in this country, about to buy a blanket bond from some one, would not need much time for a decision when given the choice between dealing with individual underwriters unknown to him and located in a foreign city and dealing with regularly organized and supervised American bonding companies. About two years ago, accordingly, a group of domestic companies, weary of seeing a large and constantly growing proportion of their bank-bond business running off their books without renewal because of these London Lloyd policies, decided to issue a similar instrument themselves, and thus to regain this business and hold it permanently, if possible. Five venturesome companies broke the ice, agreeing to participate equally in all the business that any of them might secure. A rival group of five other companies was quickly formed; and then the movement spread to all the active companies. Within a month or so from the time the first group announced its programme almost all the American companies were ready to issue blanket bonds in behalf of banks and trust companies. The London underwriters have held some of their business, but probably the bulk of it has by this time permanently repatriated itself.

Sufficient experience has not yet matured on blanket bonds to show whether or not the present rates are adequate. A recent compilation of experience figures, however, covering the two years in which the companies have been freely writing the business, showed an unexpectedly low loss ratio.

One reason why many executives vigorously opposed, and for a long time successfully blocked, the movement in favor of writing blanket bonds, was because they feared that such bonds could not be limited to banks, but would soon spread to large mercantile houses, and would ultimately be issued generally, with the net result of converting the entire field of fidelity underwriting into a virtual gambling operation. These fears seem to have been groundless. Although many big commercial and industrial concerns have tried to obtain blanket bonds, the com-

panies have steadfastly adhered to their determination not to extend the system. Possibly some modification of the present practice will come about in time; but there seems to be no indication now of any such development.

### AN INTERESTING AND FRUITFUL FIELD.

Because applications for fidelity insurance may sometimes be handled with a certain lack of judgment or even with more or less carelessness without serious resultant trouble, while even a little laxity shown at a critical stage of a piece of surety underwriting may mean a heavy loss, executives as a rule have been tempted to neglect the former division of their business in favor of the latter. Perhaps a more accurate way of putting it would be to say that their surety problems have been so numerous and knotty that every last atom of their judgment and mental power (not always so much at that) has been needed there. The fact remains that the fidelity end of the bonding business will always yield rich results to the diligent and expert producer, organizer and underwriter. Although fidelity rates have been persistently declining for years (at a greatly slackened pace, however, since the rating bureau was established), and although in some classifications the existing rates are perhaps too low for the permanent good of the business, yet statistics covering a series of years seem to show that even the present comparatively low tariff will yield a profit to conservative underwriting and efficient management.

## FIDELITY AND SURETY BONDS.

### Outline of the Character of a Surety Bond—How to Become a Compensated Surety—Various Contracts Explained.

*Paper by E. D. Livingston, Superintendent, Bonding Department of the Royal Indemnity, Read Before the Staff of the Company.*

For the benefit of those who have not had an opportunity of considering the general subject of fidelity and surety bonds, this paper will deal mainly with elementary matters. By bearing in mind a few important facts, any one may be able to recognize a contract of suretyship, and by considering a few additional facts, no difficulty will be found in determining when a requirement for security can be met by a contract of suretyship.

A surety bond is a contract in writing (known as a contract of suretyship or a contract of guaranty), referring to three distinct parties and guaranteeing that a certain party will live up to certain obligations. The party whose obligation is guaranteed is known as the principal (the principal obligor). The party for whose benefit the contract of suretyship is issued is known as the obligee and the party who guarantees to the obligee or beneficiary that the principal will live up to certain obligations is known as the surety. Therefore, our three distinct parties are the principal, the obligee and the surety. Compared with a contract of insurance, the obligee is the insured; the guarantor or surety is the insurer. The addition of the third party, the principal, creates the difference between the suretyship contract and the insurance contract.

Any one familiar with the relationship existing between the three parties on a promissory note, the maker, the payee and endorser, will have no difficulty in immediately determining the relationship existing between the three parties in a contract of suretyship. The maker of a note occupies a position analogous to that of the principal in a contract of suretyship. The payee named in the note occupies a position analogous to that of the obligee in the contract of suretyship. The endorser on a note who guarantees its payment occupies a position analogous to that of the surety in a contract of suretyship. The difference between the two instruments is that a promissory note becomes a negotiable instrument and is usually given as an evidence of debt for money loaned the maker; a contract of suretyship is generally required on account of a contingent liability which may arise.

A surety bond or contract of suretyship may take many forms, but in substance such contracts are conditioned that if a certain party named as the principal does or does not do certain things, the contract becomes enforceable and if the principal in the bond does not comply with its terms, the surety may be forced to do so. If the principal defaults and the surety is forced to make good such default, the surety may proceed for reimbursement against the principal, provided always that the bond is valid and legally exists as a contract of suretyship.

After considering carefully the few points which I have stated, I do not believe that any one will have any difficulty in determining whether a certain contract is one of suretyship or a contract of insurance or any other form of contract. After you are able to distinguish the difference, we have passed our first step. The second step is to determine when the requirement for security can be met by the issuance of a contract of suretyship and whether conditions will support the validity of such a contract of suretyship.

We have seen that a contract of suretyship refers to three distinct parties, but it is not necessary that such contract be executed by more than one party, viz., the surety. Before a contract of suretyship can exist, one party, the principal, must be under an obligation to do certain things or refrain from doing certain things for the benefit of another party, the obligee or beneficiary; between these two parties a contractual relationship must exist, such as obligor and obligee or debtor and creditor. The underlying contract between the principal and obligee may be written or oral or may be expressed or implied, or it may be in the nature of a legal obligation resting upon the principal to do or not to do certain things for the benefit of the obligee. The addition of the surety to the transaction does not change the obligation on the part of the principal; without the surety the principal would have been liable to the same extent as if no surety had been required.

If there existed no liability on the part of the principal without surety then the contract of suretyship would be invalid because the surety cannot be liable in any event until the principal named in the bond is first liable. This relationship gives the surety the right to proceed against the principal, if the surety becomes liable to pay and does pay for a default on the part of the principal. In other words, the surety always has between it and a loss some party and the surety cannot sustain an ultimate loss until the defaulting principal has been exhausted. The step which we are now considering is of great importance, and until it is thoroughly understood, practice and requirements of surety companies might not be understood. We frequently find that by not applying the few simple rules which

I have set forth above, brokers and agents endeavor to arrange a surety bond covering conditions which will not support a valid surety bond. The surety bond is a contract resting upon an underlying contract. Let us take

A CONCRETE EXAMPLE.

Security was desired by a man who was his uncle's only heir at law. If his uncle died without making a will, the nephew would have inherited a large fortune. The uncle was competent to and had a perfect right to make a will and as his uncle was very much interested in charitable work, the nephew feared that a will would be made depriving him of some or all of the uncle's wealth. The broker to whom the case was submitted suggested that a bond be issued by a surety company, guaranteeing that the uncle would not devise any of his property to any one other than the nephew. Now, by applying the few facts which we have considered, it will be readily seen that the surety bond could not be issued to take care of this contingency because the principal named in the bond would be the uncle, and as he was under no agreement or legal obligation to do that which the nephew desired to be the subject of the guaranty, the bond could not exist. If such a contract had been issued by any one and liability had resulted, the guarantor under the contract could not look to the principal, so called in the contract, for reimbursement, because the beneficiary named in the bond had no rights to which the surety could be subrogated. Therefore, such a contract would have been a contract of insurance and not a contract of suretyship. If the uncle, for a good or valuable consideration, had agreed that he would not will his property to any one other than his nephew, such an agreement would have supported a surety bond, because the uncle would have been the principal. Such principal would have been obligated without the issuance of the bond to do the things guaranteed in the bond. If the surety became liable under the bond, it would have been subrogated to the rights of the beneficiary in the bond and could have proceeded against the uncle (or his estate), who was the principal.

A THOROUGH UNDERSTANDING

of the two steps which we have considered will simplify all other elementary matters connected with the surety bonding business.

As to its form and its usefulness, the contract of suretyship rivals in antiquity any other form of contract. We find it frequently referred to in old writings and, in fact, find suretyship mentioned in the Bible.

Until recently all surety bonds were signed by private sureties, that is, by parties doing so as an accommodation or for

consideration other than the payment of a premium. Any individual who is competent to make a contract may generally become surety on a bond. The business of becoming surety for compensation by a corporation chartered for that purpose is of very recent origin. Even at this date, a large majority of surety bonds are signed by private sureties without compensation. Private suretyship has been the source of much dissatisfaction and has been found unsatisfactory to all parties interested. Unsatisfactory to the principal because he becomes obligated to the party signing his bond and may, in turn, be required to reciprocate and become his surety on a dangerous undertaking. To the beneficiaries in the bonds on account of difficulty being constantly encountered in making collections for default of the principal. It has been found that where an individual becomes surety as an accommodation, he seldom realizes the scope of the obligation which he has signed and when a default occurs is inclined to resist payment, meaning in practically every case that the obligee is able to collect only after the termination of a successful lawsuit. Private suretyship has been found unsatisfactory by those who become surety for friends and has frequently been the cause of bankruptcy on the part of such accommodation sureties.

THE ADVENT OF THE BONDING COMPANY afforded much relief to all parties to a suretyship contract and the service which is rendered by bonding companies is so universally recognized that general business, including the business of our courts, business of running the government of the various States and the Federal government would be seriously inconvenienced if compensated sureties or bonding companies should discontinue the business of becoming surety.

As we have seen, surety bonds may arise out of any contract or obligation. The purposes for which required and the forms prescribed would be difficult to enumerate. No one is able to anticipate future requirements. The bonding business has sufficiently developed to show us that certain classes of bonds predominate. I will now refer to and give a brief synopsis of such classes. I usggest that you bear in mind the two elementary steps referred to in the first part of this paper and apply these steps to the various classes which we consider.

### FIDELITY BONDS.

The first class of surety bonds issued by bonding companies was that of guaranteeing the fidelity of persons in positions of private trust. These are known as fidelity bonds and are universally required by banks and financial institutions (the demand also being large from private business concerns and growing

larger each day); guaranteeing against loss caused by dishonesty of the bonded employee.

Under a fidelity bond, the party whose fidelity is guaranteed, such as an officer, employee, agent, etc., is the principal, the employer or beneficiary is the obligee. Before a surety bond can exist, there must be a contract between the employer and the employee. This contract is seldom in writing, and if not, is always implied; an employee is under a legal obligation to his employer to faithfully perform the duties for which he is employed. If the scope of the liability under the fidelity bond exceeds the legal obligation of the employee to the employer without a bond, such liability would not attach to the surety as such, but would constitute an insurance contract.

The method of handling a fidelity bond is as follows:

An application is made by the employee on whose behalf the bond is to be issued, giving data from which an investigation may be made to ascertain whether or not applicant would be acceptable as a fidelity risk. The employer or obligee for whose benefit bond is given files with the company a schedule of statements—questions and answers bringing out the system employed, checks surrounding the employment, frequency of audits, etc., so that the company may determine the exposure and actual hazard. The contract or bond form is very simple. It refers to the employee and guarantees the employer against loss which might be sustained by fraud or dishonesty on the part of the bonded employee, the liability of the surety being limited to a stated sum.

### PUBLIC OFFICIAL BONDS.

The principals under such bonds are public officers and public employees, the obligees being the Federal government or a State, county, city, town, village, public board, etc., and superior public officers taking bond from subordinates.

A public official is under legal obligation to faithfully perform the duties of his public office in accordance with law, establishing a contractual relationship.

Practically all public officers are required to give bond, especially those handling money or in a position of trust where the obligee could sustain a loss by irregular acts.

The method of arranging for a public official bond is to require from the public official an application, giving the company information regarding the official to be bonded and the system under which the official operates, setting forth the amount of money handled, the probable largest amount on hand at any one time, etc. For the actual duties of the official and his responsibility to the obligee, we may refer to the public statutes.

After the application has been approved. the bond is issued

on a form prescribed by statute or by some supervising official in the absence of a specific form being required by statute. These bonds refer to the public official, the principal, and are for the benefit of the government, conditioned that the public official will faithfully perform the duties of his office and will account to and turn over to the proper official money and records for which he is liable. The bond does not limit liability to fraud and dishonesty as in the case of a fidelity bond, but covers negligence and, in many cases, errors of judgment and acts of deputies. The surety's liability is limited to a specific amount stated in the bond.

### JUDICIAL FIDUCIARY BONDS (COURT TRUSTEES).

In bonds of this class the principals are fiduciaries appointed by the court or appointed by will to administer and conserve the estates of deceased persons, the estates of minors and incompetents, the estates of insolvent individuals and corporations and are generally referred to as administrators, executors, guardians, committees, receivers, trustees, etc. The obligee under the bond is generally the State, which holds the bond for the protection of the real beneficiaries, viz., heirs or creditors of the estate.

A contractual relationship exists between the principal and obligee in that by the acceptance of his appointment the principal is under a legal obligation to faithfully perform the conditions of the trust reposed in him by statute, court order or will.

The method of handling this class of busniess is as follows:

The fiduciary to be bonded, the principal, makes application, giving the assets and liabilities of the estate, the name, age and relationship of the heirs and the personal financial responsibility of the fiduciary, etc.

The form of bond used is always prescribed by statute and is conditioned that the principal, the fiduciary, will collect, conserve and disburse the assets in accordance with law and under the direction and order of the proper court. The liability of the surety is always limited to a specified sum.

In addition to bonds required on behalf of persons in positions of trust, that is to say, persons occupying a position analogous to that of a trustee or a public officer or a private employee, there has arisen a great demand for bonds, guaranteeing the performance of contracts and obligations on the part of persons who are not acting in a fiduciary capacity, but occupy a position of debtor and under such contract or obligation become liable to the creditor or obligee in the event of certain things happening or certain other things not happening and in default, providing for the payment of money to the obligee or creditor. You will readily appreciate that conditions out of which these bonds

may arise are numerous. For the purpose of putting concrete classes before you, I will refer to a few classes which are in most common use at the present time.

### DEPOSITORY BONDS.

Under a depository bond, the bank is the principal, the obligee is the depositor.

The contractual relationship existing between the depository (the bank) and the depositor is that of debtor and creditor, the bank being obligated to the depositor for the return of money on deposit.

A depository bond is arranged as follows:

The bank makes application for the bond, setting forth the condition of the bank, giving the bank's last detailed financial statement and other information used as a basis for judging the management and personnel of the institution.

When the deposit consists of public funds, the form of bond is prescribed by statute or by some supervising public officer and refers to the bank as principal and guarantees in an amount not exceeding a certain penalty that the bank will live up to its obligation, viz., will refund such deposits upon demand.

These bonds are universally required by some States and generally required by public officers who are responsible personally for public funds lost by the failure of the depository. Large organizations occasionally require this protection for funds on deposit.

### BONDS IN JUDICIAL PROCEEDINGS.

A bond of this character names as its principal a party who is seeking some remedy in the courts to the possible detriment of the opposing litigant. The obligee named in the bond is either the opposing litigant or the court, which holds the security for the benefit of such opposing litigant.

The contractual relationship between the principal and the obligee arises out of the obligation of one litigant to make good to his opponent loss or damage which the opponent sustains by reason of some advantage given the principal in the course of litigation.

The method of arranging for this class of bond is as follows:

The principal or the litigant seeking the remedy makes application setting forth the facts of the case and his financial responsibility. The form of bond issued is prescribed by law and court procedure, and is generally in the form of an undertaking referring to the principal, but not executed by him. It is conditioned, in substance, that the principal will make good to the opposing litigant any loss or damages which the opposing litigant may sustain by reason of the unsuccessful outcome of

the remedy sought. Some bonds limit surety's liability to a certain sum; others are open in this respect.

The requirement for this class of bond is very general and the bond itself takes the place of the deposit in pledge of securities to protect the opposing litigant. These bonds are very commonly known as bonds on appeal, stay of execution, replevin, counter-replevin, attachment, release of attachment, etc.

### CONTRACT BONDS.

In contract bonds for the performance of work, the contractor becomes the principal. The other contracting party or the party for whose benefit the bond is issued is the obligee.

The contractual relationship in a bond of this character in practically every case is established by a written contract between the principal and the obligee.

The method of arranging for a bond of this character is as follows: The contractor who is the subject of the guaranty makes application setting forth the conditions of the contract, giving a list of the other bidders, his experience as a contractor and a detailed statement of his financial responsibility, and is required to furnish the company with a copy of the contract, plans and specifications. If all of these matters are satisfactory and approved by the company, the bond is issued.

In the case of public work, the bond form is prescribed by statute; in private work, by the architect, and in the absence of a prescribed form, the company has a special form which it uses. The surety's liability is limited to a specified sum, except in the case of bidders' bonds, which are frequently without penalty.

Contract bonds, in substance, guarantee that the contractor will perform the work in accordance with contract, plans and specifications, that the work contracted for will be kept free from liens and, in many States on public work, guarantees that the contractor will pay for his labor and material.

The demand for this class of business is very general. Practically all public work is bonded and the demand for bonds covering private work is growing daily. The operations are such as constructing buildings, subways, sewers, dredging harbors, furnishing supplies, building roads and paving streets, etc.

In addition to the above classes of bonds, we have various miscellaneous surety bonds which are very common, but which time does not permit us to dwell upon at length, such as bonds required by the United States Government guaranteeing the payment of internal revenue tax, bonds guaranteeing the payment of custom duties, bonds required by States and municipalities upon granting a license or a permit.

This brief description of the various classes of business may not give a clear idea of the actual risk assumed by the surety

and if one has had no opportunity of looking into a bonding business, he may have difficulty in determining in which class a given proposition should be placed, but as I stated at the outset. it is primarily the intention of this paper to show when a certain contract is a contract of suretyship, a surety bond, and when a given set of conditions would permit a valid bond to exist.

In conclusion, particular emphasis should be laid on the fact that a valid surety bond cannot be given in any case except where the party to be bonded, the principal, is under contract or obligation to do or not to do certain things for the benefit of the obligee, the beneficiary, and, further, that the instrument itself must refer to three distinct parties, the principal, the obligee and the surety.

## PHASES OF SURETY REINSURANCE.

### Wide Scope and Facility Given to Business Through This Means.

*By Samuel E. Thompson, Attorney in Charge of Reinsurance Department, United States Fidelity and Guaranty Co., Baltimore, Md.*

In the eyes of the average surety man, reinsurance is a loathsome term, a thing to be avoided whenever possible, and a complication of unintelligible methods, but nevertheless an evil which the underwriting of suretyship and casualty lines makes a necessity to be tolerated. As a matter of fact, in the vernacular of the present, reinsurance in its various ramifications is one of the most effective weapons of "preparedness" in the insurance world and an invaluable "aide" to the underwriter.

Without it the scope of our modern surety and casualty companies would be materially lessened, and the little as well as the big projects of to-day would soon find themselves severely handicapped in lacking the broad protection which corporate suretyship now affords.

No matter how strong a company might be financially, it would be highly impractical, if not suicidal, for it to risk a huge loss on a single proposition or even on a series of propositions relating to the same subject. To avoid such a situation and to diminish the possibility of facing what might be a catastrophe—in other words, to insure the insurance ceded—resort must be made to some form of reinsurance.

#### THE INVERSE OPERATION.

In reality, this proceeding is simple, for although reinsurance works inversely to direct in insurance, thereby confusing those but slightly acquainted with it, it is nothing more than insurance of insurance, or better, perhaps, merely an agreement to participate indirectly in the liability assumed by the insurer under its bond or policy.

Broadly speaking, reinsurance is of two kinds, "straight" and "excess," although co-suretyship, joint control and personal indemnity all belong to the same family. "Straight" reinsurance is more generally employed and is the result of an agreement between reinsurer and reinsured whereby the former undertakes

to assume a definite proportion of the liability occasioned by the latter issuing its obligation. The consideration of course is a like proportion of the premium on the bond or policy payable by the reinsured less a stipulated commission.

### TWO-SIDED CONTRACT.

The contract effected is a simple bilateral one between insurance companies and differs from co-suretyship in that it is a transaction wholly between reinsurer and reinsured and in which the obligee or assured is in no way interested. This definition does not always hold, however, when the United States, a State or municipality is obligee under a large bond, for then a special form of agreement is required or the obligee subrogates itself to the rights of the reinsured, thereby making the procedure rather in the nature of co-suretyship than of reinsurance.

But in the ordinary course of events such cases are infrequent, and in the main the customary contract of reinsurance is secondary in every respect and provides that the reinsured shall be paid the proper proportion of loss, not when the liability of the reinsured to pay is made manifest, but when the reinsured can show that it actually has made settlement. Hence it would seem that the same theory applying to insurer and insured applies to reinsurer and reinsured and that upon loss and settlement the reinsured is in the same relation to the reinsurer as the insured was to the insurer. In practice, however, comity between companies ignores to a large extent the strict interpretation of the agreement, and the reinsurer generally remits to the reinsured upon proof of loss.

### THE DUAL CONTRACT.

In contrast to this class of reinsurance and yet closely akin is co-suretyship or coinsurance. Here two or more companies are concurrently liable directly to the obligee or assured on the same risk. In other words, they execute an obligation together or issue separate undertakings covering the same hazard.

Sometimes the original instrument limits the portion of insurance to be assumed by each coinsurer, but more frequently it does not, and it is then the custom for the participating companies to define their respective liabilities in a separate contract termed a "side agreement." At all events, co-suretyship is primary, and not only is each executing company directly responsible to the obligee for a portion of a resulting loss, but for full settlement, thereby becoming a guarantor of each of the coinsurers as well as of the principal.

The only protection to be had by a coinsurer is through the law which by the theory of substitution enables a coinsurer to

be recompensed from the other coinsurers, if they are solvent, for what has been paid on their behalf.

### THE EXCESS COVER.

"Excess" reinsurance provides protection to the reinsured above a certain limit to be assumed by the reinsured. In more specific terms, the reinsurer agrees to carry a certain amount of an obligation by way of reinsurance, but is not obligated to share a loss, until the reinsured has paid a specific sum set forth in the reinsurance agreement.

In short, the reinsured, in the event of loss, settles up to a certain amount and the reinsurer pays the excess, so long as it does not exceed the limit stipulated in the agreement. This sort of reinsurance is also secondary in its nature and is a contract entirely between reinsurer and reinsured.

Its most frequent use is in liability cases, where excess limits are placed with other companies to prevent the underwriting company from departing from its fixed retentions on the various lines, and it is also employed on bonds in large penalties whose size alone necessitates reinsurance in order to conform with governmental requirements.

### A REINSURANCE SUBSTITUTE.

Joint control and personal indemnity are not in reality reinsurance and so do not fall within the scope of this article, but it may be noted in passing that the former is the result of an agreement providing that access can be had to funds or securities covered by a bond only when the principal is accompanied by a representative of the surety and that the latter is an agreement by parties interested in the subject-matter of the bond to hold the surety harmless against any loss sustained by reason of executing an obligation on behalf of the principal. Before dismissing these subjects it may also be mentioned that joint control is accepted as a substitute for reinsurance by both United States and State authorities.

### A WRONG IMPRESSION.

According to the prevalent opinion, reinsurance is a necessity only where large liabilities are concerned, but this conclusion is entirely erroneous. Indeed, reinsurance of this nature holds but a small place in the business of a company and represents but an insignificant portion of the premiums exchanged by reinsurer and reinsured.

It is very true that each surety company must reinsure practically every one of its obligations whenever the penalty exceeds 10 per cent. of its capital and surplus, as such a ruling has been decreed by the United States Government and by numerous States to

qualify surety companies to engage in the business of the government and of such States having restrictive legislation. But risks of this size compared with the gross writings of a company are extremely rare, and thus reinsurance resolves itself largely into a question of underwriting.

### AN ACADEMIC QUESTION.

The problem of how much reinsurance to place is elementary with respect to the casualty lines, for there a company sharply defines what limits it is willing to retain on each policy of a certain class of business, but in suretyship the question at once becomes academic. Here each risk stands on its own merits and must be underwritten individually with the question always foremost as to just how much a company may conservatively carry.

In the first place, the underwriter naturally must decide whether or not a risk may be approved at all, and if so, whether any portion should be reinsured. Then he must determine, if reinsurance is desired, just what the possibility is of securing the proper protection and what likelihood he has of placing a part of his risk with the contemplated reinsurer.

What one company considers desirable business another deems thoroughly objectionable, and very often the original underwriter stands absolutely alone in seeing any merits in the obligation he wishes to share with other companies. Thus frequently the reinsurer is in the position of a salesman endeavoring to sell to a prospective purchaser goods which he does not care particularly to buy, for the bulk of reinsurance is placed on small fidelity and surety bonds of which the underwriter himself is unwilling to retain but a small line. So the successful reinsurer is compelled to know well the companies with which he deals and to study their peculiarities and policies just as a salesman must make himself thoroughly acquainted with his customers.

### IMMEDIATE PROTECTION.

Peddling reinsurance from company to company has bad results, and fresh difficulties are apt to occur with each new offer. The obvious object of reinsurance is immediate protection, and this is lost when it is sought in a haphazard manner. It is gained, and with the minimum effort and cost, when the reinsurer is familiar with his reinsuring companes and their methods and is able to decide at once just where is the proper place to submit his proposition.

### BETTER FACILITIES.

Until comparatively recently the placing of surety and fidelity reinsurance was a slow, cumbersome and expensive process, each case necessitating an offer, an acceptance and a formal contract

executed with great solemnity by both reinsurer and reinsured. In spite of the fact that the fire companies had long ago dispensed with all unnecessary details in placing reinsurances and that the casualty companies had adopted a decidedly simple system in splitting their policies, yet the surety companies clung tenaciously to their formal methods, which were principally effective in being inefficient.

The result is apparent, and it is quite evident that poor service, unwarranted delays, voluminous correspondence and considerable periods without desired protection readily made reinsurance the despised subject it became in surety circles. Indeed, the ire of the underwriter has often been justly aroused by the time required to consummate reinsurance transactions, for instances have been numerous where losses occurred on bonds during the period between the time of offer of reinsurance and its complete acceptance by duly executed agreement.

Now, however, conditions have changed, and practically all reinsurances are effected on the lines employed by the fire companies and with as little regard for technicalities as possible. Here and there treaties exist between reinsurer and reinsured whereby one company obligates itself to accept all the cessions, within stipulated bounds, of another company, and a reinsurance transaction is completed upon the mailing by the reinsured of a bordereau upon which is entered a full description of the risk to be reinsured. Under this plan the validity of each reinsurance is governed by its classification, its amount and the time within which it is mailed.

### FACULTATIVE REINSURANCE.

The treaty system, however, is not usually employed to a large extent, but instead what is sometimes called facultative reinsurance is used and is completed by simple but efficient means. By this method a company enters into a general reinsurance agreement with each of its reinsurers, which provides coverage for every reinsurance effected.

The operating machinery is quite elementary. Ordinarily the company seeking protection offers a portion of a bond to its prospective reinsurer on a specified form, which describes the risk in general terms and furnishes sufficient data for the offeree to determine the desirability of the business. After considering the proposition, this company, over the signature of an authorized person, indicates on the bottom of the form "declined" or "accepted," and the proffer is either repudiated or consummated. In this way a vast amount of time, labor and expense is saved and reinsurance is secured almost immediately and with the minimum of correspondence.

## NOT AN EXPENSE.

Reinsurance has always been, and probably still is, considered a necessary expense to each surety company, but as a matter of fact it is quite otherwise. On the one hand the difference in the commission paid agents and that allowed the reinsured should not only defray the cost of reinsuring but also yield a return, while on the other hand reinsurance received from another company on its bonds may be classed in the same category as business produced by the agency force.

The judicious reinsurer, therefore, by good service aided by a broad point of view in his underwriting and with the exercise of his personality and a consideration for the other companies' methods can easily build a large trade in reinsurance and soon learns that through good, honest effort and a desire to accommodate, he is able to secure for his company a greater proportion of reinsurance than he is compelled by the dictates of good underwriting to give away. Those companies having reinsurance departments appreciate this fact more than those which have not and will undoubtedly agree that reinsurance may readily be made an attractive and profitable proposition instead of a disagreeable subject which common sense alone prevents being ignored.

# JOINT CONTROL OF THE ASSETS OF AN ESTATE

## By the Fiduciary and the Surety—Need for Better Understanding of This Safeguard.

*By Joseph W. Bristor, Attorney in Charge of Legislation, United States Fidelity and Guaranty Company, Baltimore, Maryland.*

Of the many safeguards employed in corporate surety underwriting, there is none so effective, when properly administered, none so greatly misunderstood in its purpose and administration, as joint control of the assets of an estate by the fiduciary and his surety. This misconception arises from the fact that the manner of its proper operation is not generally understood; hence the good effects flowing from its application, being unknown, are unappreciated.

The agent, usually a person of intrepid, undaunted and aggressive character, never fails to present every point tending to serve in the acquisition of the fiduciary's bond, yet, lacking knowledge of the efficacy of joint control from the viewpoint of both the fiduciary and his surety, either relegates it to the background, or if he suggests it does so in a merely perfunctory manner.

The fiduciary seeing it as a restriction upon his authority, a doubt of his integrity or fear of his ability, is unresponsive to a mere request that it be adopted.

In studying the situation from many angles and in the light of experience, I am constrained to believe that if the advantages to be derived from its operation were thoroughly understood by agent and fiduciary it would become quite general in use and be as greatly appreciated by the agent and fiduciary for its advantages to them as it is by the surety for its safety to it and lowering of the loss ratio.

### THE FIDUCIARY'S OBJECTIONS.

The fiduciary is averse to giving joint control for several reasons:

(1) It is, in his opinion, an aspersion cast upon his honesty by the surety.

(2) Being impressed with his own integrity and ability, he deems it unnecessary.

(3) He believes it to be an unwarranted attempt by the surety to meddle in his management of the trust.

The agent apparently dislikes to suggest it because

(1) Having a knowledge of the fiduciary's attitude, he sees in it a great danger of losing business he might otherwise control.

(2) If the risk is a large one and the fiduciary presumably a man of affairs and integrity, he seems to fear that the suggestion will be taken as an affront.

(3) He deems it an attempt to place a heavy burden upon his shoulders, as there may be a great deal of detail in connection with the exercising of joint control on a large risk, for which he receives no additional compensation.

These objections are without real foundation and are based upon a misconception by both agent and fiduciary of their respective duties and responsibilities, as well as a vague knowledge of the true meaning of joint control as used by surety underwriters.

The agent's aim is to secure as much business for his company as possible, and consequent increment to himself, but he must not lose sight of the fact that he must use all effort to see that that business proves valuable to the company; and no single factor tends so much to the safety of a fiduciary risk as the proper exercise of joint control over that risk.

The fiduciary's aim and duty is to conserve and administer the trust imposed on him with the utmost regard for the safety of the assets and the interests of the beneficiaries. The law requires that he faithfully perform the duties of his trust and faithfully account for the estate entrusted to him, and his surety obligates that he will so do and perform. These conditions constitute a mutual and reciprocal agreement which can best be perfected by entering into that close and confidential relationship that joint control produces.

### THE RIGHT MEANING.

The opinion is held by many, including agents, fiduciaries, lawyers, and even courts, that joint control means the turning over, by the fiduciary to his surety, of the assets of the estate or the holding of the assets of the estate in absolute joint title by the fiduciary and his surety. Such, however, is not the case. Joint control has a far different meaning. Either one of the meanings above mentioned would take from the fiduciary, or at least divide with his surety, the possession of the assets coming into his hands as fiduciary and would tend to make the surety an absolute insurer of the assets, whereas the real liability to be assumed by the surety is that the fiduciary will faithfully perform the duties of his trust and faithfully account for the estate.

Joint control is the result of an agreement (sanctioned by law

in most jurisdictions) between the surety and the fiduciary whereby the fiduciary obligates himself to place the securities and cash of the estate in some safe place from which they cannot be removed without the knowledge of the surety.

### NO VOICE IN MANGEMENT.

The surety neither has nor desires any voice in the management of the estate, does not question the proper withdrawal of funds or securities and has no physical possession of any part of the estate over which the fiduciary has control. The simple and few restrictions placed upon the fiduciary are not onerous or objectionable, but rather act as an aid to the fiduciary in his handling of the estate.

Joint control means:

First: The cash of the estate shall be deposited in some financial institution to be selected by the fiduciary or suggested by the court; the account to be in the name of the fiduciary in his fiduciary capacity. At the same time that he opens the account, he files with the institution holding the account written instructions that no check drawn upon the fund shall be honored unless it bears the countersignature of a representative of the surety specially designated for that purpose; and the financial institution must acknowledge, in writing, to the surety, that such instructions have been filed with it and express its intention to be governed thereby.

Second: The securities, such as stocks, bonds, promissory notes, and other tangible evidences of indebtedness belonging to the estate, shall be deposited in a lock-box in the safety vault of some trust company or other financial institution having such facilities, said box to be rented in the name of the fiduciary as such fiduciary, with the understanding and agreement, in writing, with such institution, that access to such box by the fiduciary can only be had when accompanied by a specially named representative of the surety delegated for that purpose.

Having thus made the operation of joint control practical and the control of the assets of the estate complete, we are brought face to face with the most important feature of real and absolute joint control, *i. e.,* its operation in a methodical, accurate and effective manner.

The surety having assumed a risk, consent by the fiduciary to joint control having been given, the arrangement regarding the checking account and the safety-box having been perfected, it is then proper that the agent should, in the record to be kept by him, enter the initial deposit and the amounts of all checks countersigned, the names of the payees and the nature of the indebtedness or claim for which the checks are given—making sure, before countersigning a check, that the expenditure is

proper and legal and that the fiduciary is properly authorized to draw the funds. The agent should also obtain, from time to time, the deposits made and enter same on his office record. Whenever an account is filed in the estate, he should check up the receipts and offset same by expenditures and should note if same balance with his record.

When the securities are first deposited in the lock-box, the agent should take a list of all securities, setting forth the amounts, character, identifying numbers or letters, etc., of the same. He should take a copy of this list with him whenever accompanying the fiduciary to the vault and should note thereon any additions made to the securities and also any withdrawals, making sure that there is full legal authority for all withdrawals or exchanges of securities before same are made.

### ANNUAL CHECKING-UP.

In exercising joint control the representative of the surety should bear in mind that his appointment is not made in order that the fiduciary should have company when visiting the vault, and he is not expected to sit to one side, while the fiduciary is handling the securities, as though he had no business there; such action would be most reprehensible. He is there to see that every security belonging in the box is placed there and remains there until its withdrawal is proper and legal. If this procedure is carried out consistently, the representative's cash balance and list of securities held will always balance when the annual checking-up takes place. This annual checking-up should be made without fail.

The selection of the surety's representative should be made with a view to his fitness for the position. He should be a person familiar with the appearance of securities, good at figures, should possess a good knowledge of accounts, be a man of good business judgment, and, above all, faithful to trusts imposed.

It is but natural that the fiduciary should object to these methods, deeming the same unnecessary, troublesome and a reflection on his integrity. This objection can be easily disposed of if the matter is placed before him in the proper manner and spirit. Instead of being a reflection on his integrity or capability, it is convincing evidence of his own assurance of and confidence in his ability to properly, systematically and legally carry out the trust reposed in him, when he is willing to have his surety placed in such a position of vantage that it can at all times see how he performs the duties of his trust. The surety places its confidence in his integrity and capability, when it assumes the suretyship. The giving of joint control by the fiduciary to his surety is therefore nothing but reciprocal confidence of the fiduciary in his surety.

## COUNTERSIGNING CHECKS.

One of the many objections to giving joint control that is urged by the fiduciary is the countersigning of the checks. The fiduciary asserts that it is too inconvenient to hunt up the surety's representative every time he has to draw a check against the funds of the estate. In many estates, generally large ones, payments by checks are made in large numbers, often in small individual amounts, and the securing of countersignature to these might cause the fiduciary some inconvenience. The surety overcomes this objection thus: When the funds are deposited and countersignature arranged, the fiduciary draws a check in an amount that will presumably cover his legal expenditures in the estate for thirty or sixty days, the surety countersigns same, and the fiduciary deposits that check in a separate account as fiduciary, without any countersignature agreement; and from this account he pays the accruing and necessary bills. When this account needs replenishing, he takes his vouchers for these expenditures to the surety, they are checked up and totalled, and, if correct, another check is drawn and countersigned to replenish his subsidiary account, thus doing away with the annoyance referred to and yet exercising consistent and perfect joint control.

It is not infrequent that the fiduciary in a large estate requests, of his own volition, that the surety assume joint control of the assets belonging to the estate, having profited in the past by the advantages accruing from such action, and desiring to have the benefit of the wisdom of the surety, acquired by long experience in such matters; thus enabling him, through the surety's experience, care and watchfulness, to keep from errors and omissions in the handling of the trust—errors and omissions which might otherwise occur and entail loss, even though the fiduciary be innocent of any wrongful intent. In this class the writer could (if it were not for the confidential relationship of surety to principal) name many lawyers, financiers and business men whose standing in their respective localities for honesty, integrity, intelligence and capability is of the very highest.

## OBJECTORS USUALLY IGNORANT.

As a matter of fact, those who most strongly object to giving joint control are those who have seldom or never acted in a fiduciary capacity and who have no knowledge of the duties to be performed and little inherent ability to fill the trust.

There is another very strong reason why the fiduciary should give joint control in large estates. Surety companies cannot, under the law, assume a risk the penalty of which exceeds ten per cent. of its capital and surplus, unless that excess is secured in one of the several ways which will be referred to hereafter, one being joint control. By this method, the surety can carry

the whole risk; without it, the surety must reinsure the excess over its ten per cent. limit. To secure this reinsurance, all information known to the original surety, copies of all accounts, inventories, orders, etc., etc., must be furnished each reinsuring company, in accordance with their reinsurance agreements, as the knowledge of the surety to make the reinsurance binding must be the knowledge of the reinsurers. In other words, all information concerning the risk coming to the surety must be conveyed to the reinsuring companies, thus spreading on the records of all the reinsuring companies all facts connected with the estate and preventing that privacy obtainable when a single surety controls the risk. This alone is a weighty reason in many instances for the giving of joint control.

When corporate surety first came into existence a great many years ago, it was possible for the surety to assume sole surety on an obligation in any penalty. At that time, there was no limitation requiring that any portion of the risk should be protected, but the surety was left at full liberty to retain the whole of the risk. As the business of corporate surety increased, it became evident that such latitude was unwise and it was thought best that some restriction be placed upon the surety when assuming large risks. In consequence, the United States Treasury Department, by virtue of the power vested in it by the Federal Government, and most of the States have limited the rights of corporate sureties to retain an amount assumed upon a risk which exceeds ten per cent. (10%) of its paid-up capital and surplus. In other words, a corporate surety can assume suretyship in any amount it chooses as original surety on the risk, provided it protects all of the liability thereunder above ten per cent. of its paid-up capital and surplus.

### TREASURY DEPARTMENT REGULATIONS.

There are several ways to protect such excess assumed, those prescribed by the Treasury Department at Washington being used as a standard. They are as follows:

"1. By the deposit in pledge or conveyance in trust for its (the surety's) protection, of property equal in value to such excess. execution and delivery of which to be made at the time of the execution of the original obligation.

"2. By reinsuring such excess in companies acceptable to the United States Government in such amounts as come within the ten per cent. limit of said reinsuring companies.

"3. By co-surety on the obligation with companies acceptable to the Government, whose liability shall be limited on the face of the obligation to an amount not exceeding the ten per cent. limit of the co-insurer.

"4. By an agreement made at the time of execution and deliv-

ery of the original obligation, for the deposit, and the actual deposit, of the assets of the estate so held, in such a manner that no further sale, mortgage, pledge or other disposition can be made thereof without such company's approval, except by the decree of court having proper jurisdiction.

"5. Or by indemnifying agreements executed by sole heirs or beneficiaries of the estate releasing the surety from liability."

Thus we see that by the fourth provision the Federal Government, through the rulings of the Treasury Department, has placed its stamp of approval on joint control and has thereby established its legality, propriety and necessity.

The Federal Government's sanction of the Treasury Department's ruling has not been without great effect in bringing this protection into general usage. New York, a State that stands second to none in enacting proper legislation covering the needs of a wide-awake, energetic and progressive commonwealth, has a statute which permits a fiduciary to consent to joint control with his surety.

Moreover, I am creditably informed that the Supreme Court of New York City has adopted a rule, as has also the Surrogate Court of Kings County, compelling joint control by the fiduciary and the surety to be put in practice in certain specified cases.

Many of the States have also adopted similar statutes, among which may be mentioned Massachusetts, Connecticut, Vermont, Virginia and Oregon.

We have thus given reasons why, from the view of the agent, the fiduciary and the surety, joint control should be given, also shown that its operation is legal.

In certain instances it is imperative that joint control be given or the fiduciary find himself in the predicament of being unable to procure a bond without it, no matter how willing and anxious the surety companies may be to serve him. For instance, the Treasury Department issues a chart every three months showing the capital and surplus of each company conducting a surety business and holding a certificate of authority from the Secretary of the Treasury under the acts of Congress of August 13, 1894, and March 23, 1910, as acceptable sureties on Federal bonds. This chart gives the amount of the ten per cent. limit for which each company may be accepted as sole surety on any one bond. The chart last issued, revised to March 1, 1917, shows that there are twenty-four such companies, with a total ten per cent. limit of $5,142,921.77, including the limit of four reinsurance companies. Consequently, a bond the penalty of which exceeds $5,142,921.77 could not be written in a manner acceptable to the Federal Government, even though every surety company acceptable to the Government and the four companies engaged only in reinsurance were on the risk, without giving either indemnity

agreements, executed by sole heirs or beneficiaries of the estate, releasing the sureties from liability, or pledging property, or conveying same in trust for the sureties' protection or joint control; yet a single surety may write a bond exceeding that penalty and retain the whole risk if joint control of the entire estate be exercised by the fiduciary and his surety.

### MINIMIZING LOSSES.

With joint control sanctioned and favored by the Federal Government, its adoption by many States, the number of which is steadily increasing as the years go by, and the favorable recognition given it by the courts throughout the country, how can a fiduciary justify himself in belittling its use, with such convincing arguments in its favor and such sponsors for its adoption?

In conclusion let me say that the surety has no ulterior motive in desiring joint control; it is actuated only through a desire to minimize its losses, minimize the losses to distributees of the estate (as ofttimes the loss greatly exceeds the penalty of the bond) and to guarantee the proper and methodical handling of the estate, all of which is of general advantage to and redounds greatly to the reputation and fair name of the fiduciary.

## BANKERS' BLANKET BONDS.

### A Description of the New Form of Blanket Protection Offered to Bankers and Brokers—Advantages, Cost and Coverage.

*By Luther E. Mackall.*

The surety companies are now issuing to banks, private bankers and stock brokers a very broad form of blanket bond, protecting them against loss of money or securities:

(a) Through any dishonest act of any of their employees, wherever committed, and whether committed directly or by collusion with others.

(b) Through robbery, burglary, theft, hold-up, destruction or misplacement while the property is within any of their offices covered under the bond, whether effected with or without violence, or with or without negligence on the part of any of the employees.

(c) Through robbery, hold-up or theft by any person whomsoever while the property is in transit within twenty miles of any of the offices covered under the bond and in the custody of any of the employees, or through negligence on the part of any of the employees having custody of the property while in transit as aforesaid.

The Lloyds Underwriters of London have for several years been issuing a similar policy in this country, and there arose among the banks a considerable demand for such indemnity from American companies. President Joyce of the National Surety Company took the lead in urging the American companies to issue such a bond, but it was not until the latter part of the year 1915 that four other companies were persuaded to join. In order to divide the risk, these five companies formed a syndicate and issued a joint bond. This was promptly followed by another syndicate of five companies, but as soon as the writing of the bond became established and the need for the syndicates disappeared, they were dissolved, and now the bonds are generally written by a single company and reinsured in the usual way.

The present form of bond, while practically the same in substance and intent as the original form, is the last of five different revisions—each made to remove possible ambiguities and to overcome objections of bankers. The present form has been adopted by the Surety Association of America and approved by

the insurance committee of the American Bankers' Association, and that committee has recommended it to the members of the association. It is believed that the present form gives complete protection and is so clear that it may not be misunderstood or misconstrued.

If a bond in an adequate amount be taken, it will remove all possibility of loss from any dishonest act on the part of any employee, from the president to the office boy, and will remove practically all chance of loss from any untoward accident of any kind. It will give to stockholders and directors a feeling of security and safety which is absolute and which they cannot otherwise secure. Attention is called to the following special features:

1. The bond covers any single loss up to the amount of the bond; and, upon the discovery of a loss (the payment of which, if not otherwise provided, would result in the reduction of the bond by the amount of such loss), the bond is automatically restored to its full amount, precisely as if a new bond for the amount of such loss were issued simultaneously with the reporting of such loss to the company. An additional premium computed pro rata upon the sum so paid from the date of the notice of loss to the end of the current premium year is charged, but the payment of this premium is not a condition precedent to the restoration, which is absolutely automatic.

2. The bank may carry fidelity bonds on its employees or not, as it sees fit. If such bonds are carried, appropriate credit on the premium for the blanket bond will be allowed, and the blanket bond will then operate as "excess coverage" as to losses resulting from dishonest acts of bonded employees and as "primary coverage" as to all other losses within its scope. If such bonds are not carried and no such credit is given, the blanket bond will operate as "primary coverage" as to all losses within its scope.

3. The bond covers all losses that may occur subsequent to its date and be discovered within twelve months after the termination of the bond; and if fidelity bonds carried at the inception of the blanket bond are then cancelled, there will be attached to the blanket bond a rider giving continuity of the protection afforded by such bonds, so that, if adequate fidelity bonds have been carried for a sufficient length of time, the blanket bond, with the rider, will, as a practical matter, cover all losses that may be discovered while it is in force or within twelve months after its termination, regardless of when such losses may have been sustained. If a policy of London Lloyds is being carried, and is cancelled, continuity of that protection will likewise be given.

4. In case of a loss in excess of the amount of the bond, all

salvage, whether recovered by the bank or the company, will be paid to the bank until its entire loss has been covered.

5. The bond is free from warranties and contains the specific provision that no statement made by or on behalf of the insured, whether contained in the application or otherwise, shall be deemed to be a warranty of anything except that it is true to the best of the knowledge and belief of the person making the statement.

6. Individual applications from the employees are not required, there being only one application, and it is to be signed by an officer of the bank.

It will be interesting in this connection to make a comparison between the protection afforded by this bond and that afforded by the best that can otherwise be secured, namely, a combination of fidelity bonds, burglary insurance on the safe and vaults, interior hold-up insurance and messenger hold-up insurance. It is not practicable to point out *all* the contrasts, but the more important ones are as follows:

1. This bond provides indemnity against loss on account of dishonest acts of any employee up to the full amount of the bond, while the indemnity under fidelity bonds is in a limited amount on each employee; and in practice it very often happens that in case of loss the bank is not fully protected. The latest large bank fidelity loss is that recently reported by the Liberty National Bank, where an employee holding a relatively minor position abstracted over $50,000, and it is said that, while the bond on the employee was unusually large, still it was not sufficient to cover this loss.

2. In providing indemnity against loss through robbery, burglary, theft or hold-up while the property is within any of the insured's offices covered under the bond, this bond gives all the protection that would be afforded by burglary insurance on the safe and interior hold-up insurance, and, in addition, covers: (a) A loss through sneak thievery, as where the money is stealthily taken from the teller's cage, an occurrence that has been rather frequent of late, particularly in New York and other large cities; and (b) a loss of property which, through negligence on the part of an employee, is not put in the vault and is taken by an outside person. In addition, this insurance is wholly free from restrictions and warranties, so that there is no danger of failure on technical grounds.

3. In covering loss through messenger hold-up, this bond is free from restrictions as to the amount that may be carried within the limit of the bond, and contains no requirements for guards. The ordinary messenger hold-up insurance is limited in both of these particulars. The underwriters of a blanket bond will expect an insured to follow established practice and not to

entrust extraordinary amounts without reasonable safeguards, and if it does not exercise appropriate safeguards the underwriters will probably not continue to carry the risk; but the point is that the bank is not in danger of losing the benefit of the insurance by an occasional departure from established practice.

4. This bond covers loss through negligence on the part of the messenger, and is intended to cover any loss in transit within the prescribed limit, howsoever it may occur, while the hold-up policy only covers loss through an actual hold-up and forcible taking of the money or securities.

5. This bond covers loss through destruction of money or securities within the premises of the insured, whether by fire or otherwise. This is not covered by any of the forms of insurance above mentioned.

6. This bond covers misplacement of money or securities within the insured's premises. This is a new and important feature, not covered by any of the forms of insurance above mentioned. Recently the cashier of a bank in Boston took from the vault a package of fifty bonds of the State of Massachusetts, each for $1,000, intending to return them to the vault. When he looked for them a month later they could not be found. Such a loss would be covered, while it would not be covered by any other form of insurance now available.

This bond will be issued in amounts ranging from $25,000 to $300,000, and the premium to incorporated banks will be computed in accordance with the following schedule:

PRIMARY COVERAGE, $25,000.

25 employees or less—$25 for each employee; minimum premium, $625.

26 to 50 employees—$625 for first 25 employees; $15 each for remainder.

51 to 100 employees—$1,000 for the first 50 employees; $10 each for remainder.

101 employees or more—$1,500 for the first 100 employees; $5 each for remainder.

PRIMARY COVERAGE, $50,000.

Add 15 per cent. to the premium for primary coverage of $25,000.

PRIMARY COVERAGE, $75,000.

Add 25 per cent. to the premium for primary coverage of $25,000.

PRIMARY COVERAGE, $100,000.

Add 30 per cent. to the premium for primary coverage of $25,000.

PRIMARY COVERAGE, $125,000 AND UPWARD.

Add to premium for primary coverage of $25,000 an additional 5 per cent. for each $25,000 in excess of $100,000.

EXCESS COVERAGE, $25,000 AND UPWARD.

Compute premium or minimum as for primary coverage in the amount desired. Allow $1.50 per $1,000 on the underlying fidelity schedule. Net premium to be not less than one-half the premium or minimum for primary coverage in the same amount for the same employees.

The rate for private bankers, primary or excess coverage, is 20 per cent. in excess of the rate for incorporated banks, minimum premium, primary or excess coverage, $750; and the rate for stock brokers, primary or excess coverage, is 50 per cent. in excess of the rate for incorporated banks, minimum premium, primary or excess coverage, $1,250.

This system of rating may seem complicated, but is easily applied to any particular case; and it gives a rate which is fairly proportioned to the risk and which enables a bank to get an adequate amount of bond at a reasonable cost.

In fixing the minimum premium at $625 it is realized that many banks will not feel justified in paying this amount and will therefore be excluded from the benefits which this bond gives. It was felt, however, that this bond should be written only for the larger banks where it could be assumed that the bank had first-class burglary-proof safes; had a sufficient number of employees to operate as a check one against the other; and a good system of supervision, audits and checks; and it was felt that this premium would automatically exclude the smaller banks where the risk is known to be extra hazardous due to the small number of employees, the lack of supervision, audits and checks, and the number of cases where such banks have poor vaults and equipment. It was thought that, as to the burglary hazard, these small banks should be rated separately, each on its own equipment, and that this could be done only through regular burglary insurance, and that it would be unsafe, for a premium which these banks could afford to pay, to give the large fidelity coverage contemplated by the blanket bond. In practice the dividing line seems to be between banks having more, and banks having less, than twelve employees, although several banks having less than twelve, and one having only eight employees, have taken a bond of $100,000, paying therefor a premium of $812.50. The experience of the companies during the past year indicates that ultimately all banks having more than ten or twelve employees will take this form of bond.

In writing this very broad form of bond in such large amounts, the companies realize that they are bound to have not only the

ordinary losses up to, say, $10,000, but also some very large losses; and it is a serious question whether or not the business will be profitable. It will depend not only upon whether the rates would, in the long run, produce a profit, but also upon whether the total premium income from this class of business will be sufficient to make operative the insurance law of average upon which the rates are based. This problem was a very serious one for the companies when they first began to issue this bond, but now, at the end of one year, the total premium income is in the neighborhood of $500,000 and will probably be very much increased during the year 1917; and it is felt that this is probably large enough to enforce fairly the law of average. If, with this volume, there is no profit, the only conclusion that can be reached is that the rates are not adequate.

## THE EMPLOYER AND THE SURETY BOND.

### Origin of the Obligation to Secure Fidelity—Causes of Defalcations—Methods of Safeguarding Them.

*By W. M. Tomlins, Jr., Vice President, American Surety Company, New York. An Address to the New York Electrical Railway Association.*

The obligation to secure the fidelity of an employee seems to have been brought within the charter powers of a corporation in London in 1720 when, by reason of the losses caused to employers by servants, a meeting was had at Devil Tavern, Charing Cross, and subscription books were opened and a society created with a capital stock of £1,000 to insure all masters and mistresses against losses sustained by thefts of servants ticketed and registered by the society.

Following that, but some 120 years later, there was a discussion in the "Dublin Review" by Professor Morgan of the feasibility of fidelity insurance and its relation to the laws of general average, the theory of Professor Morgan being, apparently, that the number of persons out of a thousand taken at hazard who cannot resist a given temptation would be found to be nearly the same as those in another thousand who cannot resist.

Then came the organization of the Guaranty Society of London, to which great objection was raised, it being urged that the entire plan of the business was speculative and that a master would hesitate to accept an employee who could only give corporate security for his honesty. "The moral security" is wanting, was the exclamation of all. It was apparently vain to answer that the objection pointed both ways and that a relative would often give the required bond which a surety company would refuse. Time passed, and it became apparent that, because the banker's clerk gave the security of a company, he did not become a rogue but, in fact, became independent of the undue obligation to his surety. It was also found that an employer could more readily collect his claim from a corporate surety than from a personal bondsman with whom he perhaps might be on terms of personal acquaintance.

#### UNDER INSURANCE LAWS.

From these starting points, the present fidelity suretyship seems to have been a natural growth. It is true that surety companies

are organized under the insurance laws of the different States, but this is more because of the necessities of the occasion than because suretyship is insurance. There are, in fact, substantial differences between suretyship and insurance; for instance, insurance may be oral but suretyship for another must be in writing. By insurance, the insurer takes the hazard without expectation of indemnity, while in suretyship the surety in every instance has the right of recovery from his principal. In insurance there are only two parties—the insurer and the insured—while in suretyship there are three parties—the principal, who is or may become a debtor and must indemnify the surety, and the one who is or may become a creditor, and the surety. In insurance the insurer is bound on the happening of the event insured against while in suretyship the surety is only bound in case the principal fails to discharge his obligation, and so on.

### DEALING WITH EVILS.

Generally speaking, the purpose of fidelity suretyship is to indemnify the employer against loss from the dishonesty of an employee. It has been well said that suretyship grapples with the human will and, while admitting the temptations which constitute the necessity for protection sought, it credits mankind with resisting causes which exist against wrongdoing and so arrive at a medium capable of precise estimate. It has not created an evil, only emphasized its existence and improved the method of dealing with it. It is exclusively a technical moral hazard; that is, a hazard whose basis is essentially the integrity of the person whose conduct forms the basis of the risk. Suretyship, therefore, rests upon the admitted necessity in the modern business world of greater protection to individual ownership and personal rights. The methods used in judging of the acceptability of an applicant for suretyship are practically the same in all companies, the principal features being

The receipt of an application wherein the following information is given:

(1) The names of former employers for a period of at least ten years.

(2) He is also required to give us the names of from five to seven references.

(3) Information of his financial responsibility, the amount of his salary, his debts and the number of persons depending upon him for support.

We also make it a point to inquire into the standing of the employer, both moral and financial, and particularly with reference to the safeguards surrounding the employment and the system in use by the employer to prevent losses and how often the applicant's books and accounts are examined.

## THE EMPLOYER'S STATEMENT.

A prolific source of trouble in the past in connection with fidelity bonds has been what is sometimes called the Employer's General Statement, a document by the surety companies required from the employer stating the methods of their business and those details which from the surety's standpoint have been necessary to enable it to determine whether appropriate safeguards are by the employer thrown around the employee. A moment's reflection will show you how necessary it is for the surety to have something of that kind upon which to determine its course of action, but, unfortunately, the practice grew up, with some companies at least, of so framing those certificates as to justify the assertion when a loss came that the statements in such certificate constituted a warranty to the effect that the employer would exercise the oversight in the future which he had exercised in the past over the employee, and hence that, inasmuch as something had been overlooked, the surety could not be required to pay.

Experiences have, however, convinced most, if not all, of the surety companies that even in those cases where they take such a certificate it shall not constitute more than a mere statement of the employer as to the methods of transacting that part of business with which the employee is connected, so that if, through some inadvertence, some one of those methods be overlooked or perhaps intentionally dispensed with, it will not interfere with the employer's right of recovery from the surety if loss be suffered through the wrongdoing of the employee.

## HONESTY THE BEST POLICY

The safety of such a business consists in inducing those who are covered by its bonds to believe that honesty is the best policy and to live and act accordingly. It recognizes the market value of a good reputation, right living, creditable family connections and a good home. It is undoubtedly true that placing an employee under bond throws around him a wholesome restraining influence, for, when thus under bond, he knows that another obligation than that of faithfulness to his employer rests upon him. No supervision, however careful and thorough, ever prevents losses.

Experience teaches that honest men rarely become dishonest in a day. Temptation when first encountered is easily resisted. Defaults are small in the beginning and gradually increase to enormous amounts if not soon detected.

Persons of experience have found that those in positions of trust who speculate in stocks, grain provisions and like commodities, lured on by the hope of retrieving past losses, become defaulters to large amounts. It has been observed that persons

in positions of trust who are in the habit of gambling will sooner or later become losers and, in consequence, defaulters, though the defaults consequent to such misconduct are not nearly so large as those resulting from speculation involving sums of greater amount than those at risk in games of chance.

It is generally true that persons in positions of trust who live beyond their incomes are likewise greatly exposed to the temptations of small peculation, particularly if addicted to immoralities and other excesses.

Financial and other institutions do not procure bonds of suretyship to take the place of the duties of the managers of such concerns, but to protect a risk ever present with the strictest supervision and the most approved system of accounts. The interests of the insured and the insurer are identical. Each is interested in and seeks to prevent a default.

### CONTRACT BONDS.

This is a prolific source of income to the various companies and in the past few years has assumed large proportions, both as to premium and losses. It has such a wide area and the requirements are so great that companies employ and keep employed trained and technical men who have made a careful study of the subject from the theoretical as well as the practical side.

In bonds conditioned for the performance of contracts to do different kinds of work, you are interested from two standpoints, the first, where you are required to give a bond, as, for instance, where you are doing work for some one else, and the second, where you take a bond from some one who is doing work for or under you, as, for instance, where you take a contract and sublet portions of it.

Naturally, the owner for whom you are doing a piece of work cannot need anything more from you by way of obligation or security than that he shall be indemnified against any loss which he may suffer by reason of failure on your part to perform your contract, but, curiously enough, the form of bond required has outgrown all proportions until now you find yourself frequently asked to give bonds conditioned not only for the performance of the contract but also to protect the owner against many imaginary losses for which he cannot be held liable, the excessive liability of which bonds leads the surety company, of course, to charge more for the obligation, which, because of its terms, leads to successive troubles and litigations, all causing unnecessary expense and trouble.

As an illustration, let us suppose that you give a bond conditioned for the performance of a contract and for the payment for all materials which may be used in the construction of a piece of work. The owner would not be liable for materials save

possibly through the medium of a mechanics' lien, which must be filed within a very short period of time after the work is done. You, having sublet a portion of the work and the sub-contractor having failed to pay for materials, find yourself, after you have paid the sub-contractor in full, months afterward, perhaps, in the uncomfortable position of having demand made on you by those who furnished the sub-contractor with materials and who have lost their right of lien by delay, so that you had no notice of what was going on, and of being compelled to pay simply because of the form of bond by you given, all of which might easily have been voided by simply giving a bond to indemnify the owner against any loss which he may suffer by reason of your failure to perform your own contract, and bond in that form is all that the owner could possibly require.

It is not to be lost sight of, however, that contractors of doubtful responsibility are sometimes found in the position of advocating the giving of a bond which shall constitute a direct promise for the payment for materials and everything else to the end that, because of their financial inability to meet their obligations, they may buy on credit, finish the job which they have taken at a very low figure, collect everything collectible and then decamp, all of which, as we can see it, is to the detriment of the contractor who tried to get fair pay for his work and who of necessity must get fair pay to the end that he may keep his own obligations.

### INDIVIDUAL SURETIES.

Corporate suretyship, whether of the fidelity class or the contract class, or otherwise, is far more to the purpose than the suretyship of the individual. Surety companies, to succeed and thus be able to continue in business, must secure adequate compensation for the obligations they assume. At the same time, they must not make their charges for their suretyship too high. In other words, there must be plain, simple, fair dealing on both sides. It is to your interest, as well as to the interest of the surety companies with which you deal, that you and the company shall be reasonably satisfied. This being so, you must be as fair with them as you expect them to be fair with you.

# BURGLARY AND THEFT COVERAGE.

## The Development and Functions of Burglary and Theft Insurance. Description of Forms in Use and Underwriting Problems.

*By E. B. Anderson, Royal Indemnity Company, New York City.*

Burglary insurance was born in Reading, Pa., in the year 1892. Its corporate parent was the American Casualty Company. Its baby days were spent in complete isolation, but as it grew to boyhood it was permitted to play with theft, robbery, etc., and from then on its education and growth were really remarkable. It has grown to be a fairly husky and prosperous adult, and now enjoys an annual income of about four million dollars.

Dealing with the subject concretely, there are in common use now eight forms of policies: four residence policies, comprising burglary, theft and larceny and what is known as "burglary only," under the so-called blanket form, with co-insurance clause policies for each of the types; and four commercial policies, styled mercantile stock, mercantile safe, messenger robbery and bank burglary.

The difference between the two general forms of residence policies is that under the so-called "burglary only" policy visible evidence of a burglarious entry must show. That is, the entry must be effected by tools or explosives and there must be marks of the entry upon the premises. While under the burglary, theft and larceny policy no visible evidence of a burglarious entry is required. The co-insurance clause policy differs from the blanket form only in this respect—the insured is a co-insurer, if he does not carry insurance up to 80 per cent. of the value of certain articles which are specified in the co-insurance clause.

### BLANKET FORM.

Of these forms, by far the most widely sold is the residence burglary, theft and larceny blanket form policy, which insures household property and is akin to the household furniture fire policy. This form, which covers thefts committed by servants, as well as by others, encroaches to some extent on the bonding department, as it guarantees the honesty of domestics. However, as we have never heard any complaints from that department, nor from the different State insurance departments, we may assume that we can go on in our iniquitous way, quite properly "stealing" business from "bonds."

Burglary may be defined as the breaking and entering a building with intent to commit a felony therein, whether the felony be actually committed or not.

Larceny may be defined as the wrongful and fraudulent taking and carrying away by one person of the mere personal goods of another from any place with a felonious intent to convert them to the taker's use, without the consent of the owner.

Theft has no legal definition and may be termed civil or non-legal larceny. A man's a thief, but he is indicted and tried for larceny, the degree depending upon the amount stolen. The reason for the use of the two somewhat synonymous terms lies in the fact that if we covered larceny alone, it would be necessary to require a claimant to produce the culprit, and in surprisingly few instances are we able to do this.

### THE MORAL HAZARD.

Throughout burglary insurance underwriting, the moral hazard of a risk is the paramount factor in determining its desirability. In residence theft and larceny insurance this is especially true, as this policy is practically a sight draft on the company, to be cashed whenever a person sees fit, and the necessity for carefully scrutinizing applications for this insurance is becoming more apparent day by day, as the loss ratio of the different companies is steadily rising.

We have several more or less efficient aids to the determination of the moral aspect of a risk, such as retail credit guides, investigating bureaus, etc.; but in my opinion, reports secured from these sources cannot be relied upon with any degree of certainty. Information respecting the applicant is usually secured from his friends or acquaintances, and it is difficult to glean much of value from those reports. Yet despite this condition, the number of *known* fraudulent claims is remarkably few; the number of unknown fraudulent claims, obviously, cannot be estimated. And we attribute our rising loss ratio on this form of insurance partly to the increasing professional criminal element and partly to the increasing number of servants with a criminal bent—although we never lose sight of the effect which morality has on our loss ratio.

### NECESSARY INSPECTIONS.

Residence risks are accepted without an inspection of the premises, excepting in the case of flat houses, which are inspected because the possibilities of getting in are greater than in private houses or in elevator apartments. A common dodge of flat-house thieves is to ring the bells of the different apartments until one is unanswered. This flat is then the thief's objective point, and once in the building, it is comparatively easy for him to "jimmy" the door. It will be seen from this that it is wise to avoid a

risk where all of the family are known to be out during the day. Of course, we have this sort of condition confronting us with practically all risks which we write, but unknowingly.

Let us now deal with the residence policy in its concrete shape. It covers the holder, all members of his family who permanently live with him, and also persons, not members of his family, under the same conditions of residence, if they do not pay board or rent. It does not cover property owned by domestics, unless specifically insured. Personal property of every description, excepting only animals and stamp and coin collections, is insured by the policy, though the money cover is limited to $50. The policy is not a floater, and covers only within the residence of the insured, although we do allow insurance to the extent of $50 on property contained within a store room, if the policyholder occupies a flat or an apartment. The policy contains a specific limitation of $100 for the loss of precious stones, watches and articles of jewelry, after the premises have been left vacant for more than eighty-four consecutive hours; other personal property, however, is not affected by this limitation. This clause is familiarly known as the eighty-four hour clause. Subject to this clause, the premises may remain vacant for four months without prejudice to the insurance. To cover, though, during any further period of vacancy, the policy must be endorsed and an additional premium paid.

### MECHANICS CLAUSE.

In the residence theft and larceny policy you will find what is called a "mechanics clause." This clause excludes liability from loss arising as the result of theft and larceny while all members of the household, including servants, are absent from the premises, and mechanics are given a free run of the place. Under these conditions, however, it does cover a loss arising from a burglarious entry, which, if you will recall the definition, requires force and violence to consummate. Consequently this clause will not be found in the "burglary only" policy. This company recently introduced a feature which appears to be of practical use and is gradually being adopted by other companies. It is a condition which permits the subletting of a residence without notice to the company, but during the term of the lease the policy does not cover silverware for more than $100, and excludes money, watches, goldware, jewelry, precious stones and property of the lessee or his family, and loss or damage caused by the lessee as well. So much for the residence policy.

### MERCANTILE FORMS.

Next in order of importance is the mercantile stock policy or, as you might call it, the store insurance policy. The cover under this policy is restricted to loss occurring as the result of a

burglarious entry of the premises, and there must be visible evidence of this sort of an entry to validate a claim under the policy. Entry is effected in more ways than I can take the time to tell you about now. Our old friend the jimmy plays an important part in stock burglaries, although to a certain extent a more complicated, and presumably more effective, instrument is used than is the case when a flat is burglarized. We now have to consider the uses to which a sectional jimmy may be put. Rope ladders also play quite an important part in these burglaries, one having been used, and incidentally found, at the scene of a recent burglary which was committed against one of our policyholders. Our friends, the burglars, have the unpleasant faculty of keeping up with the times and we shall not be the least bit surprised to learn at any time that an aeroplane was used to carry burglars to the scene of their operations and to carry them away with their loot, after the job was finished. Automobiles *now* play a prominent part in burglaries.

We require that inspections be made of every mercantile stock risk, and in those cases where what we call the physical protection is not strong, if it can be done, we require the premises to be improved. In those cases where this is not possible, we decline to cover. There are innumerable safeguards and safety devices on the market, but probably the most efficient, surely the most widely known, of these devices is the Fox police lock.

### PREVENTIVE MEASURES.

Other devices, such as braces for sliding doors, cross bars for rear doors, iron bars for exposed sashes or sliding windows, are commonly employed. Many of the high-grade merchants have installed burglar alarm systems, some few of which are good, but many of which are what you might call indifferent, and, therefore, bad. The best burglar alarm system is what is known as the "central station alarm." In the event of the alarm being set off, it sounds in a station where there are patrolmen and watchmen on duty. Other systems provide for the ringing of a gong outside of the building in which they are placed, and which call wandering special officers to the scene, i.e., the alarm is supposed to call these officers, but is not always successful. One incident is told by an interested and more or less amused observer. Imagine, if you will, Twenty-fourth Street, West, just off Sixth Avenue, about 11 o'clock at night. Excepting for the lights on the avenue, the street was dark. As this person was coming out of the Masonic Temple on the south side of Twenty-fourth Street, the gong in front of a fur store, across the street, sounded, and he waited a minute or two to see what would happen. Up sauntered one of the blue-coated special officers, employed by the burglar alarm company, who gazed at the alarm, and while the

look of disgust on his face could not be seen, it must have been there, for he shook his fist at the alarm and then sauntered off, as leisurely and carefree as he had sauntered up.

### DISSECTING THE MERCANTILE STOCK POLICY.

If a burglarious entry has been effected, it covers merchandise which is owned by the insured, or held in trust or on commission, or sold but not removed, and for which he is responsible. The policy covers certain risks in either of two ways, one with a 20 per cent. limit on several specified articles and the other without limit on these articles. For the first cover a lower rate is named than for the latter. When covering jewelry risks, a limit of $25 is placed on all articles not contained within a locked safe. Other merchandise is insured without limit in certain cases, and in some a specific limit is placed. Property contained within a show window is insured up to $200 against loss occurring by having the glass broken and the goods abstracted through the aperture. If, however, the premises are entered, and goods are abstracted from the show window, the policy covers without limit. In the last year or two, thanks to a frill introduced by some company, we have extended our stock policies to cover money, stamps, etc., without charge, up to 10 per cent. of the amount of insurance while these things are contained within a safe in the insured's premises. You will note, of course, that the new features in our policies are not frills; they are "practical uses," but if other companies introduce new features, that is different. The company's liability under this form of policy is limited to the cost of the goods stolen, and in case of a pawnbroker's risk, to the actual amount loaned on pledges. The policy does not cover loss or damage during a fire, nor to plate glass, nor if the company cannot determine the amount from the insured's books; nor does it cover when the premises are open for business, excepting only in case show window insurance is written to cover specifically when the premises are open for business.

### SAFE COVERAGE.

Next we come to the company's mercantile safe policy, which covers money or merchandise while contained within safes or vaults under practically the same insuring conditions as the mercantile stock policy, excepting that the burglarious entry must be made into the safe or vault which contains the property insured, and this entry must be accomplished by the use of tools, explosives, chemicals or electricity. I cannot for the life of me, though, advise you why tools or explosives would not be sufficient, as you can readily appreciate that tools of some sort would have to be used in connection with chemicals or electricity, unless you assume that a burglar could use a handful of chemicals or electricity. I doubt it, though.

The construction of the safes or vaults must in each case be described, as rates depend upon the type of safe in use. A fireproof safe is usually an iron shell filled with concrete. A burglarproof safe, or a burglarproof chest, according to the requirements of the policy, must have steel walls (either plate steel or solid steel) at least one inch thick and the doors must be one and one-half inches thick. Plate construction means layers of steel, riveted together; solid construction means a single piece of steel.

## ROBBERY PROTECTION.

Now we have a different sort of insurance from any previously discussed, although it is underwritten by practically all companies which write burglary insurance—and in the burglary insurance department, too, even though it is not burglary insurance. I mean robbery insurance, where, again, we may be infringing on the rights of other insurers. As the greater number of these policies cover robbery on the highways, in railroad trains, steamships and public or private conveyances of all sorts, we are really underwriting the perils of navigation or transportation, which from a statutory viewpoint should be dealt with as marine insurance. We have never been hindered in writing this insurance, though, and probably never shall be.

Robbery is defined as the felonious taking of personal property in the possession of another from his person or immediate presence and against his will, by means of force or fear. So please bear in mind that to commit a robbery somebody must be present to be robbed. To a layman there is no difference between burglary and robbery, as he feels he has been robbed if anything has been stolen from him, irrespective of the means used to take the property, yet there is a marked difference, as a burglary can be committed whether the place burglarized is occupied or not.

There are what one might call two sorts of robbery risks underwritten—one, outside robbery, discussed briefly before, and the other, interior or store robbery. The cover of the first, with the exception of pay-roll money, ends when the conveyance of the property insured ceases; that is, as soon as the messenger or paymaster, or whatever the employee is called, ends his trip, either at the premises of the insured or at the bank, in the event of carrying deposits, or elsewhere, as the case may be. If we insure pay-roll money, the cover is continuous from the time the money is withdrawn from the bank through the process of carrying it to the premises of the insured, until it is made up in envelopes and paid out to the insured's employees. Interior or store robbery insurance applies onlv within the premises, and during the time the premises are usually open for business. In each form of policy, however, there is a time limit of cover. In

outside robbery insurance the usual hours are from 7 A.M. to 7 P.M., in the other from 7 A.M. until 12 midnight.

### A BROAD FORM.

This form of policy is very broad in its scope, yet singular though it may seem, the company's experience has been especially good. It covers the loss of the property insured if taken feloniously from its custodian by force or violence. As a matter of fact, though, the expression with "force and/or violence" is redundant, as robbery cannot be committed without force or violence, and in this respect, of course, robbery differs from larceny. The policy excludes loss occurring during a fire in the premises; if a messenger, paymaster, guard or office employee is implicated in the loss; if the insured's books are not kept in such a manner that the company can determine a loss from them; or if a messenger or a paymaster is under seventeen years of age. The policy contains, however, what is called a "misstatement clause," which provides that if the insured fails to comply with the warranties made in the application, and a loss occurs, the insurance is not rendered void. The company is required to prorate such a loss according to the amount of insurance which the premium paid would have purchased under the changed conditions.

### BIG BUSINESS FROM BANKS.

Last, but not least, is bank burglary insurance. Competition for bank risks is keen, as it is probably, from the company's standpoint, one of the most desirable kinds of business to get. There are several State bankers' associations throughout the country, all of which are amalgamated with the parent organization, the American Bankers' Association. Fortunately, few of the State bankers' associations have arrangements with any single company to underwrite risks for their members. The practice of making contracts with State bankers' associations, formerly quite common, has successfully been done away with by the Burglary Insurance Underwriters' Association, excepting with contracts which could not be cancelled.

This policy covers burglary from the safes, robbery in the daytime and in the night time, too, although the latter hazard is practically non-existent if a time lock protects the bank's safes or vaults, for the combination cannot be manipulated until the time set. The company issues two forms of policies, its own and the copyrighted form of the American Bankers' Association. The first is practically obsolete, as there is an almost universal demand for the American Bankers' form.

The burglary and robbery covers under this policy are no different from similar risks under other forms, but the night robbery cover is somewhat different, as it applies also in case

an officer or an employee of the bank, with knowledge of the combination, is compelled to unlawfully open the safe, and the bank's property is stolen in consequence.

### SAFES AND VAULTS.

In the early days of bank burglary insurance the type of safe and vault construction was much inferior to the modern equipment. Up to a certain point, bank burglars have kept pace with improvements devised by safe manufacturers, but they have not yet developed means of burglarizing the highest type of modern bank safe. This feat could be accomplished if burglars could work uninterruptedly for a sufficient length of time, but they cannot, so they have turned their attention to more spectacular, but easier, ways of getting money from a bank. And that is by daylight hold-up. It is remarkable how many of these hold-ups occur and how few come out in the newspapers. One occurred recently in Crockett, Va., which cost the Royal over $4,400, and some trusting dealer the temporary loss of an automobile. The crew came to the outskirts of the town in a hired car, stopped and trussed the chauffeur up like a Thanksgiving turkey, and threw him in the bushes, coming into town under their own steam. On reaching the bank they found the cashier and a patron in earnest discussion. The chances are that the discussion was continued in the bank vault, for that is where the two men were put, and the robbers helped themselves to all the money that was loose. They forgot, though, to throw the combination of the vault far enough, and after about fifteen minutes' work the cashier and a very nervous patron released themselves from the vault. I presume that the cashier was nervous, too, but that is not a part of the story. The climax and the rest of the story lies in the issue of the draft. Like testimonials in ads, the truth of this will be found in our files.

I could gather quite a collection of anecdotes, portraying spectacular hold-ups, but time forbids, though these crimes constitute something of a risk.

### GENERAL CONDITIONS.

I have discussed before conditions which affect the cover of particular forms of policies in use. However, in all policies will be found what might be construed general conditions. These conditions set forth the manner in which a loss must be reported and what the insured must do in case of a loss. The right to replace property instead of settling in cash is provided for. There will also be found stipulations respecting fraud, inspection of premises, other insurance, cancellation of policy, statutory limitations, etc. but there is no necessity for discussing these matters here. You may regard these general conditions as the constitu-

tion of the policy and the so-called special conditions as the by-laws, even though the by-laws are printed first.

Just a moment now for applications. You might think that this subject should have come before we touched upon policies, but as we see the application first and then think about the policy in connection with the application, it doesn't look so much like putting the cart before the horse. All burglary applications start with the name of the applicant. Thereafter, not always in the same order, though, we find his address, the nature of his business, if he has ever been declined for burglary insurance or if a burglary insurance policy of his has been cancelled, if he has ever suffered a loss or if he carries other insurance. In one statement he specifies the amount of insurance desired and the manner in which it is to be written. Each application taken is analyzed rapidly, and from the mental picture presented by the application we form our opinion of the risk. We have a claims clearing house in the Burglary Insurance Underwriters' Association, to which all reports of losses are sent and through which claims experience is disseminated to members. In the event that another company has settled a claim with one of our applicants, we secure full information respecting the claim from the other company. Sometimes it develops the applicant states that he has suffered no loss, yet bureau information shows that he has had one or more claims. What we do with that application depends entirely upon the nature of the claims.

THE SUBJECT OF RATES.

Specific rates are provided for each class of insurance which is underwritten. For residence and mercantile stock insurances a graduated scale has been adopted; in the other branches the rates are charged on a percentage basis, and no discounts are allowed for excess insurance. In most of the commercial insurances discounts are allowed for watchmen's services, burglar alarm systems, etc., and in bank and mercantile safe, population discounts, as well, are permitted.

The settlement of claims, quite naturally, is a serious matter, and in numerous cases it requires some finesse to dispose of a claim in a manner satisfactory both to the claimant and to the company. You can readily appreciate the difficulties surrounding the disposition of a theft claim in which there is no evidence whatsoever that the property missing has been stolen. And our troubles are not lightened by the fact that we cannot properly require evidence of that sort before admitting liability for the claim. It is not always possible to secure corroborative evidence of a theft. In such cases—and each is a law unto itself—we do the best we can to treat the claimant fairly and not waste the company's money. The "ready reference" system, adopted last

spring by the police department in New York, has proven to be of quite some value in our claims work, and as late as last Thursday we discovered through that department that a ring stolen from one of our policyholders could be found in a pawn shop on Eighth Avenue and Forty-second Street. It is remarkable, though, the few cases in which stolen property is disposed of through legitimate channels. We had one claim recently which presented an unusual feature. A loss occurred under a mercantile stock policy, and some pieces of velvet, along with other merchandise, were taken and sold to a "fence." This man evidently was either new to the game or old and careless, for he took a piece of velvet into the firm which had just been burglarized and attempted to sell it. We got him and about $400 worth of stolen goods, but that was all; where the rest went we do not know.

# MAINTENANCE BONDS.

## On Concrete Roads and City Pavements—Construction of the Bond—Fulfillment of Conditions.

*By Edward Hoopes, Philadelphia, Pa.*

Before directly considering the question of underwriting in connection with these roads, a few words on the construction of a surety bond may be of interest. Primarily, every bond written by a surety company consists of three main parts: the obligation, the description and the conditions.

The obligation is simply an agreement in which the principal binds himself to pay to the owner a certain specified sum of money, and the performance of this agreement is guaranteed by the surety.

The description is a brief abstract of the conditions which the bond guarantees, and is given to identify this particular obligation and the conditions which follow, with the contract about to be performed or that has just been completed.

The conditions are obligations which must be fulfilled either by the owner in order to recover on a bond, or by the principal in order to avoid payment of the obligation. Briefly, they state that if the principal completes his contract, or maintains the work, as the case may be, then the obligation set forth in the first paragraph of the bond is void.

While there is an infinite variety of bonds written by surety companies, the ones of direct interest to the contractor are limited to about four types: proposal, construction, supply and maintenance bonds.

Bonds covering proposals for work are of two kinds:

First: Proposal bonds in which the liability is specified in a definite amount, and

Second: Guaranty bonds in which the liability is open and which usually cover the difference between the bid of the contractor covered and the bid of the contractor to whom the work is awarded in the event of the original contractor failing to enter into a contract and furnish satisfactory surety.

Construction contract bonds are various in form, but all cover the one object; namely, the completion, under certain conditions, of the contract in question.

Supply contract bonds are similar to construction bonds except that they cover only the fulfillment of contracts for furnishing supplies, materials, etc., and do not involve the construction features or hazards.

Maintenance bonds conditioned for the maintenance of the

contract; that is, the replacing of defective work and maintaining the construction up to a certain standard for a stated period, such as paving guarantees.

Maintenance and efficiency obligations are frequently combined in the construction or supply contract bonds. Thus, where the contract, or the specifications which are considered a part of the contract, contain a clause calling for maintenance, then the bond which guarantees the fulfillment of the contract also covers the maintenance; because the contract is not entirely fulfilled until the full maintenance term has expired. Many contracts contain these clauses, and in such cases it is not unusual for the surety company to carry the maintenance obligation without without executing a separate maintenance bond.

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Maintenance of roadways from a surety company's viewpoint brings up several items that must be considered. Probably the most important is whether or not the roadway prescribed will fit the requirements of the traffic that is to use it. This can only be determined after a most careful study of the nature and volume of the traffic to pass over the street, the character of the neighborhood in which it is situated, and its physical nature.

As an example: We know of a street in Baltimore which for years has been one of the main arteries between certain freight yards and steamboat wharves, and which thus carried a large amount of traffic that was interchanged between them. A part of this street passed through one of the best residential districts in the city. Here, although a comparatively dense traffic must be provided for, it was necessary that the paving be smooth enough to eliminate all unnecessary noise. In other places, particularly on the somewhat steep hills and where these were in the business districts, another type of pavement would be required. The paving of this street thus required a somewhat exhaustive study to properly solve.

### CONCRETE FOUNDATION.

Surety companies have found, generally speaking, that it is undesirable to guarantee a pavement for five years unless it is

laid on a concrete foundation, not less than six inches thick on streets where the traffic is heavy, and at least four inches thick in residential districts where the traffic is light. This requirement is essential no matter what the wearing surface may be. Unfortunately, but few bonds have been in force for the full five-year period on pavements with a concrete wearing surface, therefore the experiences of surety companies on maintenance bonds on this type of pavement are not yet available.

Even though the work may have been performed in the best possible manner, something may happen which will injure the pavement, thereby necessitating repairs, and the contractor will not in any way be responsible. An example of this would be the case of building bonfires in streets. This was frequent in the past at election time in certain cities, and may happen at any time when mischievous boys get together. A fire on wood-block or sheet asphalt would greatly damage that part of the paving, and a report of the occurrence may never reach the department most interested; but when defects appear the contractor is called on to make repairs.

Even where the subject has been carefully considered and every effort used to lay the best type of paving, traffic may change or increase so rapidly that the paving will not meet the requirements of changed conditions. Not long ago a girder for the balcony of a new theater was placed on a four-wheeled truck and hauled through the streets for about twelve blocks. The weight of the girder was seventeen tons, that of the wagon about two tons. The load was not evenly balanced and it was estimated that the weight on the rear truck was about fourteen tons, or seven tons per wheel. Our company's engineer first noticed this truck when it had broken the covering of a manhole, and he then followed the trail of the truck and found distinct marks on the asphalt blocks, and on the sheet asphalt a depression of about 3/8 of an inch. Where it passed over granite blocks, these were chipped and the corners marked. This pavement was laid on a six-inch concrete base; but if the contractor had "shaved" this or used inferior material, there would have been much more serious results.

An article in *Engineering Record* speaks of a thirty-three-ton girder for the new Equitable Building, being hauled through the streets of New York. Only the best class of paving can stand such traffic, and if these pavements had not been carefully selected and well laid there would likely have been trouble on maintenance bonds.

It is not exceptional to-day to see eight-ton trucks in all sections of the city and country; and traffic conditions change so rapidly that no one can foretell what the future will develop. Although a pavement may be put down in what was, at the time

of its construction, a residential district, neither the contractor nor his surety has any guaranty that before the expiration of the maintenance period the locality in which the pavement is laid will not become a manufacturing center, or that a large manufacturing district will not spring up near by, resulting in the pavement in question being used as the main thoroughfare to the business section of the city. Under these circumstances one can realize that very heavy traffic would pass over the pavement, so that it would be called upon to meet conditions for which it was not designed, and in all likelihood absolutely unable to successfully withstand. If the pavement wears out as a result of such conditions, we have found that the contractor is still supposed to make good to the extent even of rebuilding the pavement, if necessary. Naturally he feels this is an injustice; but the burden of proof of so showing falls on him and is not by any means an easy task. If we were on the bond of such a contractor and he died, failed or left for parts unknown before this time, you will appreciate the unfortunate position in which the surety would be placed.

A brief study of maintenance conditions of various cities throughout the country will show a great lack of uniformity; and should a conference such as this be held next year, it would be of great benefit not only to those interested in the construction of concrete roads, but to the paving and road building contractors at large, to have a committee prepare uniform maintenance conditions that could be recommended for use to the engineers of States, cities and municipalities having in charge the construction of streets and roadways.

### CITY SPECIFICATIONS.

Extracts from the specifications of a few cities will illustrate the wide variations in requirements.

The city of Washington, D. C., inserts the following paragraph in its proposal form:

"Guarantee.—All curb, gutter and cement concrete work under this contract will be guaranteed and kept in repair by the contractor without cost to the district for a period of five years from date of its acceptance by the commissioners. This date shall be the date of the final voucher for each street hereunder. Ten per centum of the cost of this work will be retained and disposed of as provided by law. No retent will be held on the other items of work."

The payments are made as follows:

"Payments.—Payments will be made monthly provided the progress of the work is satisfactory, less 10 per centum of each estimate, to be withheld until final payment; but 10 per centum

of the cost of the work will be retained and invested as hereinbefore provided."

The 10 per centum referred to as being retained constitutes what is known as a "Retained Fund," which is covered by the following conditions:

"Retained Fund.—The retained fund shall be subject to the control of the commissioners of the District of Columbia for the purpose of maintaining the work in repair and making good any defects during the period specified, and insuring that the terms of the contract shall be strictly and faithfully performed. In the event of the contractor failing to make such necessary repairs after notice to do so, the commissioners may cause such work to be done and deduct the cost of same from the retained fund, and, in their discretion, may require of the contractor and his sureties that any portion of the said retained fund which may have been expended for the maintenance of the work shall be made good by further deposit."

The city of Philadelphia makes the following provision for maintenance:

"The contractor agrees to guarantee the maintenance of each pavement laid under these specifications and contract for the following periods of time from the date of completion and acceptance by the city:

"(a) Pavement paid for wholly by the city, bituminous, three (3) years; granite block, one (1) year; vitrified block, five (5) years; other types of pavement, no guarantee required unless otherwise indicated on the proposal or bid form. Concrete and vitrified block gutters will be maintained as long as the longest guarantee on the roadway proper.

"(b) Pavements of any character paid for in whole or in part by assessment bills: five (5) years."

During this period of time the contractor must, at his own expense, maintain the entire pavement in satisfactory condition, including the foundation, and the contractor agrees to adjust any inequalities, settlements or other unsatisfactory conditions that may occur or develop in any portion of the pavement, supplying all necessary materials and doing all necessary work, and at the end of the specified period to deliver the pavement or pavements to the city in a condition satisfactory to the engineer, without any additional allowance or compensation.

Under Section "b" you will note the work is paid for in whole, or in part, by assessment bills; that is, the owners of the adjoining property are assessed for their proportionate share of the costs, and these bills, if not paid within a certain period, become a first lien on the property. This raises a most interesting point as to the legality of such a method of payment. Most city charters provide that the cost of construction alone

may be assessed upon the property owners benefited, and several courts have ruled that the cost of maintenance should be borne by the city alone, and cannot be charged against the abutting property.

The city of Buffalo is one of the few cities still requiring a ten years' maintenance covered by a surety bond for the full period. However, even though this term is longer than required by other cities, it has not proven as great a hardship on either the contractors or the surety companies as in many other instances where the maintenance period has been for a shorter term. This is because the inspection of the work is of the highest order and only the best materials can be used; and the specifications call for a paving that, when properly laid, should easily last ten years.

Yet it appears eminently unfair under any conditions to ask a contractor to replace the paving entire during the tenth year of the maintenance period; nevertheless, these conditions are part of the contract, as shown in the following paragraph:

"If in the last year of maintenance it is found more than one-half the total area laid under this contract has been repaired (excepting cuts made for underground work), then shall the contractor cut out to the base all of the asphalt and binder laid under this contract and lay new asphalt and binder. In all these repairs the asphalt removed from the street shall be the property of the city and shall be disposed of by the contractor as the chief engineer may direct."

The city of Newark, N. J., has a still different system to cover maintenance. The guaranty condition states that:

"The whole work of constructing and laying the said pavement and all its appurtenances is to be done and completed in a workmanlike manner, and the contractor is, in general, to do all and everything that may be necessary for the construction, laying, completing and maintaining of the best kind and quality of pavement, and to the satisfaction and approval of the Board of Street and Water Commissioners of the City of Newark; and while the said work is to be done under the inspection or supervision of the board or its authorized agents, yet the contractor and his sureties shall be responsible in every respect and at all times for a period of five (5) years from the date of acceptance of said pavement, by or on behalf of the city of Newark, for the complete and perfect construction, repair and maintenance and condition of said pavement as herein provided."

To cover the contract and maintenance the contractor is required to give two bonds before the contract shall become effective.

Such bonds are required to be as follows:

"First. A bond for the faithful performance of all the

provisions of such contract, relating to the construction and laying of the pavement and its appurtenances; said bond to be in the penal sum of the total amount bid by the contractor for the pavement and its appurtenances.

"Second. A guarantee for the faithful performance of the contract provisions relating to repairing and maintaining the pavement and its appurtenances in good serviceable condition at all times during the period of five years from the date of acceptance of the pavement by or on behalf of the city, the contractor to make all repairs which are due to defective workmanship and materials, and to furnish new and proper materials in place, without any compensation. This bond shall be in the penal sum of one-half the amount bid by the contractor for the construction and laying of the pavement and its appurtenances, in the first instance. This bond must be duly executed by the contracting party, with a corporation as surety, and such corporation shall be duly authorized by the laws of the State of New Jersey to become such surety, and be satisfactory to said board.

"In addition to the two bonds given by the contractor, as aforesaid, the contractor's guarantee shall be further secured by the Board of Street and Water Commissioners, on behalf of the city, retaining 5 per cent. of the total cost of the contract work as per final estimate. The contractor will be paid 2 per cent. at the expiration of the third year and the balance or 3 per cent. at the end of the fifth year, provided the contractor has made, at any time during the respective periods, all the repairs necessary to maintain and place the pavement and its appurtenances in good serviceable condition and replace any material which may prove to have been defective or of inferior quality when it was originally placed in the work. If the contractor fails to do so, the chief engineer, on behalf of the city, shall have the right to purchase such materials and to employ such persons as he may deem necessary to make the required repairs, after the expiration of two days from the date of a written notice to the contractor, or his legal representatives, demanding the making of such repairs. The amount of money so to be retained under this contract may be applied to making the repairs and purchasing the materials. The balance, if any, between the amount so expended by the city and the percentages retained for the respective period shall, upon the expiration of the period, be paid over to the contractor. If the percentages retained are not sufficient, the difference shall be collected from the contractor or his sureties."

### NEW YORK'S REQUIREMENTS.

The City of New York calls for a maintenance of five years

with a retainage of 10 per cent., which may be released at the rate of 2 per cent. each year.

Birmingham, Ala., includes a maintenance guarantee in the construction contract, but inserts a clause in the contract which gives the city the right to decide within sixty days after the completion of the contract whether or not it will call on the contractor to guarantee the maintenance of the paving. If it so elects, the contractor then files a maintenance bond with the city. The contrator recites a certain price for a straight construction, and an additional price if the city elects to require maintenance. The contractor must bid both on construction and maintenance; but the city reserves the right to accept the construction alone, or both construction and maintenance.

On bonds of this class where a specified amount is received for the maintenance, the surety company usually requires the contractor to deposit with it the sum received for the maintenance, which amount is sometimes held by the surety for the full maintenance term, or sometimes released in proportion as the maintenance period elapses.

L. S. Bruner, engineer in charge of the Concrete Extension Bureau, says that in Canada most pavements are laid without guarantees, the maintenance being assumed by the owner.

What has just been quoted fully emphasizes the wide variation in requirements. There is one more example we might cite, one where the requirements of the county engineer were so arbitrary that a large surety company instructed all its local agents that under no conditions were they to execute bonds for the work. A portion of the specifications read as follows:

"Bids will not be received or considered on a yardage basis. All bids shall be for a lump sum for the entire work completed, and must be understood to cover every contingency, etc."

This, in itself, is drastic, but under the heading of "Maintenance" we find the following:

"Maintenance shall not only include and cover inherent defects in the pavement or the improvement, or foundations thereof; or in any of the other items of work embraced in the contract, but shall also include wear and tear by reason of the use of said highway by the public; but maintenance shall not include any damage to pavement or work, or foundations thereof, or any of the other items of work embraced by this contract, which may be incurred by the action of the State highway department or authorities of the county, in disturbing the same, or by or under any grant, privilege or permit granted to others so to do by any persons or board having authority to make such grant.

"It is understood and agreed by the contractor, his bondsmen,

and indemnitors on his bond, that the State highway commissioner shall be the sole judge of the contractor's maintenance obligations, its scope, extent, and that the rule, decision and requirements of the said official made in good faith, shall be final and binding on all parties concerned, without appeal to the courts by either the contractor, bondsmen or indemnitors on the bond, or by the county road commissioners, and it is further understood that the bondsmen of the contractor shall be bound and obligated to promptly execute the maintenance obligation of the contractor in case of the default of the contractor."

An analysis of this clause discloses that the surety agrees to waive any and all rights that it usually has, and places absolutely in the hands of the State highway commissioner practically unlimited powers as far as the maintenance is concerned. Neither the contractor nor the surety, nor even the indemnitors (should there be any) seems to have any rights whatsoever.

It is the opinion of most surety company engineers that when paving of any description is laid in strict accordance with the specifications of the engineer under whose supervision the work is being done, and under his inspection, no maintenance bond should be required beyond a period of one year. It is best that all work be guaranteed for a one-year period, so that any vital defects of wotkmanship or material can be replaced at the expense of the contractor. However, where maintenance bonds are required, probably the biggest feature in the work is whether or not the contractor does an honest job. It is a very simple matter, even with good inspection, for the contractor to cheat the work. I have in mind one case where the sub-grade was raised two inches by sand and only four inches of concrete used, the sand, of course, being much cheaper.

Also, I am advised that in one city under political control a contractor would frequently lay paving with a five-year guarantee, and at the end of about three years, when repairs were becoming numerous, would receive a new contract for repair work. However, under the present form of government the contractor is now making these repairs without extra remuneration.

### FEATURE OF MAINTENANCE.

Three features that enter into the subject of maintenance more often than any others are:

First: Has a proper study been made of the future traffic? Obviously this cannot be done by the surety company as the premium does not justify this expense and the company must rely on the engineer in charge.

Second: If a proper study has been made, do the specifications call for roads that will carry the traffic for five years?

The engineers for the sureties can usually determine this fact only when they know what traffic conditions are expected.

Third: Will the contractor give an honest job? The reputation of the contractor, which can be ascertained by the surety, will answer this question.

It is not to be expected that any roadway can last for a period of five years without some repairs. The great question is, how much will these repairs cost, and has proper provision been made to take care of them?

To suppose that any pavement will require no maintenance for the first period of five years after being laid assumes that it is made of material that undergoes no change whatever, either from the action of traffic or the elements. As no such paving material exists, the expression that a pavement requires no maintenance for five years means merely that it is constructed of material in which the changes produced by traffic and the elements are so slight as not to impair either the appearance or the purpose of the pavement. Where pavements have been properly designed, as has been pointed out in this paper, and where supervision and proper inspection have been employed, there are many types of pavements which will last for five years or even longer with but slight repairs. But some repairs are always to be expected and provision must be made for maintenance.

Owners frequently overlook the position of the surety company in the matter of a bond. A bond is given to obviate the necessity of the contractor putting up securities or counter-indemnity with the owner; and the contractor in securing the bond should realize that he is securing a loan of credit from the surety company. Therefore he should not expect to receive loans from the surety when he would not be entitled to a loan from a bank. However he can usually borrow more credit from the surety than dollars from the bank, because his loan can more easily be repaid to the surety. This payment is made by simply fulfilling his contract.

In some cases where a failure occurs and the work is re-let to another contractor, who, in turn, must give bond for completing the contract, the measure of damage is immediately established as the difference between the new bid and the amount left in the owner's hands to complete the original contract. More often, however, the surety's liability is not ultimately fixed until the contract is entirely completed and all his bills settled and claims adjusted.

Finally, the tendency of surety companies is increasing toward exacting collateral where maintenance bonds for a period greater than one year are involved.

I quote from Mackall's "The Principles of Surety Under-

writing," under the subject of "The Underwriting of Maintenance Bonds":

"Five-year maintenance on street paving is the most frequent subject of maintenance guarantees; and when such bonds are applied for, the whole proposition should be carefully considered, as such guarantees are particularly hazardous, unless conditions are exactly right, and collateral security is generally necessary. The risk that is necessarily involved in such a guarantee is great enough, but it is well known that in nearly every city there are a number of contractors who have sufficient political influence to so blind the city inspectors that they will permit inferior workmanship and the use of inferior materials; and some cties and towns, particularly the smaller ones, in order to save expense, will sometimes specify an inferior pavement and nevertheless expect a five-year guarantee."

One of the best discussions on this subject is "Pavement Guaranties, Their Use and Abuse," by J. W. Howard, a paper read before the Board of Trade, Newark, N. J., December 11, 1907. This is well worth reading and contains many interesting phases of this subject. The entire paper is summed up, however, in the brief statement that these guaranties should either be shortened to a period of one year or be abolished entirely.

One fault of a long-term maintenance is that the engineers endeavor to shift the responsibility for the quality of the work to the contractor. S. Whinery, in his "Municipal Public Works," says:

"The general theory upon which the contractor is required to guarantee the work done by him for a period of years is, that under such a requirement the responsibility for the good and sufficient quality of the work done and materials used is largely shifted from the city to the contractor, since his self-interest must compel him to perform his work in the best possible manner, in order that it may endure through the period guaranteed, and be accepted by the municipality at the expiration of that period."

And again as follows:

"As a bond must run for a period of years, personal sureties cannot be relied upon since an individual who is wealthy to-day may be a pauper before the end of five years; and the only reliable surety must be that furnished by responsible surety companies. These companies are naturally averse to underwriting bonds, even for contractors financially strong, extending over long periods of time and involving many uncertainties; and if they do so, they charge high rates for the service, which must be paid by the contractor. He must, therefore, necessarily charge such prices for his work as will yield a sufficient sum above reasonable profit to meet these charges."

I take exception, however, to the statement that the surety companies charge high rates for their service. I do not think the present rates are excessive, but I do know that the requirements of the surety companies in writing long-term maintenance are very strict; that is, the contractor must either be very strong financially or must deposit collateral.

From what has been said, and especially from the experience of the city of Birmingham, Ala., it would seem better from a business point of view to separate maintenance from construction, and, if it is thought best to have the pavement maintained by contract, separate contracts for maintenance should be made. Even these should be for a period never exceeding five years—the usual maintenance term. It would therefore appear that the best practice would be to include one year's maintenance in the construction contract and then have the city provide to carry its own maintenance.

## BONDS COVERING WAR TAX

### On Liquor—New Condition, Unlikely to Occur Again—How Written.

*By George C. Sinclair, Chicago Bonding Company.*

There are many lines of business in this country which to-day are experiencing new conditions, and the surety business is one of these. The bonds required by the United States Government in connection with the super tax on distilled spirits are of a character which is new to the surety companies, and when the present demand has been satisfied, it is not likely that a similar condition will ever occur again.

Under the war revenue bill which was passed by Congress and became a law on October 3, 1917, it is provided that all distilled spirits in the country, whether domestic or imported, shall be taxed. All distilled spirits which are in bond at the time the law became effective, or placed in bond subsequent to that date, shall pay the tax of $1.10 per gallon as formerly provided and an additional tax of $1.10 per proof gallon or wine gallon when below proof. If, however, these spirits are withdrawn for beverage purposes or to be used in the manufacture of beverages, the additional tax shall be $2.10 per gallon instead of $1.10 per gallon. All distilled spirits out of bond and on which the taxes as provided by law have been paid, if held by any person, partnership or corporation in a quantity in excess of fifty gallons, shall pay an additional tax of $1.10 per gallon. If, however, these spirits are intended for sale as a beverage or to be used in the manufacture of beverages, this additional tax shall be $2.10 per proof gallon.

#### INVENTORY REQUIRED.

These spirits, whether bonded or free, must be inventoried and the inventory filed with the local internal revenue collector, who will then levy, assess and collect the tax. This tax was due and payable on November 3, 1917, but in lieu of payment, the person, partnership or corporation might file a bond at that time, conditioned that the principal will pay his tax to the collector within a period of seven months from the date of the act. Originally, it was ruled that this bond should be in an amount equal to double the amount of the tax, but this ruling was corrected to make the amount of the tax and the amount of bond the same. The penalty for failure to comply with the law is a fine of not more than $1,000 or imprisonment for not more than two years.

As soon as the law became generally known and understood, there was an instant demand made upon the surety companies everywhere to execute the bonds. After the surety companies had examined the law and the conditions in connection with it, they decided generally that the surety was assuming a pure financial guarantee and the bond should be classed as such. Owing to the fact that many companies do not write bonds of that character, such companies refused to execute the bonds and made no attempt to solicit the business. Other companies, however, felt that they might be written and immediately began to formulate underwriting requirements which would furnish sufficient protection to the surety.

### SOME WITHOUT COLLATERAL.

It was decided that the bonds for clubs and first-class hotels might be written without any collateral. The heads of organizations of this character are invariably responsible individuals and the organizations in themselves are not dependent for their existence upon the sale of liquor. In many cases their liquor business produces a small part of their total revenue. In addition, clubs and hotels possess property which is not peculiar to the manufacture or sale of liquor, and which, in the event of a claim being filed against the bond, could, it it were necessary to take such action, be easily disposed of by the surety in making settlement. The amount of the bond desired by clubs and hotels was found to be relatively small, for the reason they do not generally carry a very large reserve supply of liquor.

With these exceptions, it was plainly evident that the surety on these bonds would be assuming too great a risk unless collateral equal to the amount of the bond was obtained. The surety, in addition to assuming a financial guarantee, a class of bonds naturally hazardous, must also take into consideration the fact that their principals are engaged in a business, the future of which is very doubtful. An applicant may be able to show substantial assets at the time the bond is written and these same assets may be entirely dissipated before the bond expires on May 3, 1918. According to present indications, many now in the liquor business will be forced out in the near future. Under these conditions, the collateral should be cash or its equivalent.

### RECEIPTS AS COLLATERAL.

For these bonds, warehouse receipts for distilled spirits were considered the same as cash collateral, for the surety can then be certain that his principal makes no withdrawals until he has paid the tax due on them. As a large part of the liquor dealer's assets are represented by warehouse receipts covering distilled spirits, it became necessary to determine their worth as collateral. Whisky at the present time is selling for $5 to $6

a gallon retail, but a surety company assuming a risk of this character is not justified in allowing the full market value. A nominal value was taken which would give a sufficient margin of safety and that decided upon was $1 a gallon on distilled spirits in a bonded warehouse and $2 a gallon on distilled spirits in a free warehouse. It was necessary to consider the fact that the tax of $1.10 as provided under the old law has been paid on spirits in a free warehouse. Cash, good stocks and bonds, valued somewhat below market quotations, and life insurance policies with a surrender value, were also acceptable as collateral.

Mortgages on real estate, whether first or second, were not acceptable, as the surety would be forced to consume too much time and incur too much expense in verifying titles and recording the mortgages. Personal indemnities, regardless of the strength of the indemnitor, were not recognized.

### RETAIL DEALERS.

Manufacturers and wholesale liquor dealers in most cases were able to meet the collateral requirements with warehouse receipts, as practically all of their stock is held in free or bonded warehouse until it is sold. The average retail dealer, however, was in a much more difficult position, as all of his stock was in his saloon, or, as it is termed, "on the floor." The retail dealer with few exceptions does not keep much stock in reserve and whatever reserve he has is generally taken out of the warehouse and stored on his premises. To obtain warehouse receipts it was necessary to carry his liquor to the warehouse, and this would leave him without liquor enough to carry on his business. Unless the retailer possessed other acceptable collateral, he was unable to have his bond signed by a surety company. This condition was brought to the attention of the government at Washington, and requirements were changed. A personal surety showing ownership of sufficient real estate can be accepted by the internal revenue collector.

In general, the liquor dealer or manufacturer who could meet the requirements of the surety companies found it advantageous to have them sign his bond. In cases where he had sufficient cash to pay the tax immediately, but little additional, he would probably be without the funds necessary to carry on his business if he made the payment. Money borrowed from the bank would cost 5 or 6 per cent. in interest, while the surety company charged only 1 per cent. on the amount of the bond. Also, arrangements were made whereby he could obtain his warehouse receipts at any time by depositing cash with the surety company equal to the collateral value of the receipts which he wished to withdraw.

The surety companies which have written these bonds will be unable to determine whether the business is good or bad until the bonds expire, for there has been no previous experience with bonds of a similar nature on which to base judgment. However, companies which have taken care to see that their interests were properly protected will find the business to have been very profitable.

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## Post-Mortem Pastimes.

A large surety company, with a queer idea of recreation, has been amusing itself with a study of recent contract-bond losses and trying to trace back to their original sources in the application papers the payment of $500,000 under contract bonds. We can imagine few diversions more exquisitely delightful to a surety underwriter—it is a rare form of sport.

The lamentable result decomposes under analysis into sixteen general causes. It is interesting to know that more than half of these causes owe their existence to the fact that the company either did not take the trouble to make, or (more probably) was not permitted by the heartless agent to make, the proper investigation; that is to say, 65 per cent. of the losses finally paid were preventable, and might have been wholly or largely avoided if the agent and the company (yes, that is the proper sequence) had made a thoroughgoing investigation of the conditions before the bond was issued.

It is interesting to know, too, that most of the remaining causes might also be said to be preventable—"unreliable or tricky indemnitors," for example, and "fraud on the part of principal." Clearly, such possibilities would usually be eliminated by an exhaustive investigation.

We grieve to note, and we transmit the information in a subdued and apologetic tone, that about 8 per cent. of the losses were incurred in connection with bonds "forced upon the company by repeated pleadings of agents," and that 11.2 per cent. were incurred on bonds "executed by agents and not approved by the home office."

The surety company in question has a practiced and a very able staff of contract underwriters, and we presume that its experience is not materially different from that of other companies doing a similarly large volume of business. Surely it all demonstrates the need of time and research and eternal vigilance in the underwriting of contract bonds.—*Fidelity & Casualty Bulletin.*

## BANKERS' MUTUAL SURETYSHIP.

### Efforts to Establish This Plan by American Bankers' Association Based on Misinformation.

At the May meeting of the executive council of the American Bankers' Association a resolution was adopted to take a referendum vote with reference to the establishment of a stock or mutual company to be controlled by the banks, with line of hazards restricted to bank risks. A referendum committee was appointed which has placed the referendum before the banks, and the vote is now being taken. The matter is one of vital importance to every surety agent in the country and every one should take a vigorous part right now in demonstrating to his own bankers the fallacy of this plan.

When the matter was placed before the executive council the main argument used for the formation of such a company was that the rates for burglary and fidelity insurance charged by old-line companies are too high. In advocacy of the proposition alleged statistics were presented tending to show that the companies received large amounts of premiums and paid little losses. The statistics then presented are again brought forward in a pamphlet which accompanied the referendum sent out by the referendum committee. The statistics are those presented to the American Bankers' Association 1916 convention and showed what purported to be the premiums and losses on burglary and fidelity bonds in seventeen States. No reason is advanced for not including any statistics relating to premiums and losses in all of the other States.

#### INACCURATE INFORMATION.

These statistics are inaccurate and misleading. Inaccurate because by very wide margin they do not show the actual losses paid by surety companies on these classes of bonds and policies. These figures as to losses were those that the committee gathered from various banks. Their weakness as reliable statistics lies in the fact that all banks did not report, and therefore the committee did not obtain reliable information. For instance, the statistics show that losses paid in the seventeen States in fidelity bonds aggregates $34,332.16. Three companies alone in that year paid over $421,000 in losses on bank fidelity business. These losses included all States. The pamphlet issued by the referendum committee shows alleged losses incurred in only seventeen

States. The information given in the pamphlet is misleading because it tends to convey the impression that bank fidelity losses incurred in 1916 were very small, whereas the fact is they were large. As to burglary losses, the information given in the pamphlet is just as misleading. It shows that no bank burglary losses were reported to the insurance committee of the association in 1916 as having been sustained in Arkansas, giving the impression that no losses were sustained. One company alone actually paid losses in Arkansas in 1916 which amounted to 137 per cent. of its net premiums. The pamphlet does not show any losses in Montana for 1916, whereas one company paid in losses in that year 101 per cent. of net premiums. Just why the referendum committee should place before the banks of the country statistics which are so misleading is not entirely clear. It would seem that it would have been better taste on the part of the committee to have submitted the referendum without any statistics than to give those which are so inaccurate as to be misleading.

THE FACTS IN THE CASE.

The surety and burglary companies prepared a pamphlet which through their agency force have been widely distributed to the banks. The pamphlet was prepared with the utmost care and is to be commended for its accuracy of statements. It shows that the rates on fidelity and burglary business have constantly been reduced. It shows the large capital that will be required of a stock company in order that it may do business in every State, which will be necessary if all members of the American Bankers' Association are to be served with equality. It shows the large taxes and license fees necessary in order to qualify in every State.

It shows the large losses that have been sustained by banks. It shows the large list of companies that have failed, indicating that the mortality rate of such companies is exceedingly high. It shows that a new fidelity and burglary company, such as is proposed, could not hope to offer any immediate reduction below existing rates, and that such a company would enjoy neither the financial strength nor the complete organization which the existing companies offer. To compete successfully for business it would require a competent and well-organized managerial and agency force, as well as one skilled in the underwriting. The pamphlet issued by the surety and burglary companies should be scrutinized carefully by every banker and the statements therein contained should be carefully compared with the statements issued in the pamphlet sent with the referendum by the referendum committee, and it is believed that after doing so the banks will quickly come to the conclusion that there is

another side to the question than the one presented by the committee.

SAFETY AND SOLVENCY.

It has been the aim of the surety and burglary companies to reduce their rates to the lowest point consistent with safety and solvency. It is not believable that the banking fraternity expect the surety and burglary companies to conduct their business at a loss. To do so would weaken the companies financially to the extent that the security offered by them would be precarious, to say the least. Such companies can no more afford to write their business at a loss than a bank can conduct its business at a loss. If a bank continues to do a losing business it does not afford safety to its patrons. The same holds good of the companies doing a surety and burglary business. It is not probable that the surety and burglary companies make more from bank business than the banks make in their transactions with the surety and burglary companies. There would seem no logical reason or any pressing necessity for the formation of such a company. It is up to the agents of the surety companies to assist in every way possible in demonstrating this fact to the banks and to the public at large.

## Prospects for Bonds.

Now, a word as to those who are prospects for fidelity bonds. Every employer, whether an individual, a partnership or a corporation, which employs men and women having in their custody money or other property belonging to the employer, or for which he is responsible, is a prospect. That is the reason the new bond is so worded.

The writer had occasion some time ago to visit a newly-appointed agent in one of the smaller towns of the East. Greatly impressed with the size of the retail stores, he inquired of the agent whether any of the proprietors of these stores bonded their cashiers, clerks, bookkeepers, salesmen and other employees, emphasizing the question by a specific reference to a large furniture store just across the street. The reply was that as furniture stores were not mentioned in the Manual, the agent presumed we did not write that class of business. It is a safe bet that his assumption was the same as to all wholesale or manufacturing establishments, and all other classes of buiness which we do write, but which do not happen to be specifically rated in the Manual, or shown in its index. As a matter of fact, the store referred to (the large furniture house) was the very kind of an establishment which produces the best fidelity business. It is not target business, and for that reason practically renews itself. The same is true of the smaller manufacturers and wholesale houses. The fact that they are small is no reason why they do not need fidelity bonds; in fact, they need such protection more than the stronger concern to whom a loss of a few thousand dollars would not be a staggering blow. If they have a clerk, bookkeeper or cashier handling money, they should be protected. The fact that they are small or financially weak is the very best reason why they should carry fidelity insurance.

In all lines of insurance (personal or property), the individual or firm who can least afford to pay the premium is the very one who can least afford to be without the insurance when trouble comes.

A great many employers arrange to have their insurance expire during the month of January, or around the beginning of the year. You probably have a list of such employers. They may be customers of yours in other lines, or they may have promised you their business at its expiration, or they may be new prospects whom you have at some time or other contemplated calling upon. In any event, go to see them now. Explain to them exactly what a fidelity bond covers, and by the time you are ready for your follow-up call (if one is necessary), you will be in position to submit to them what we believe to be the best and most liberal form of fidelity coverage obtainable.—*The Fidelity Journal.*

## Fidelity Target Risks.

*The Fidelity Journal.*

The writer knows of a man who at one time had what was considered a large insurance business. If the size of his business had been measured by the commissions alone, it was large—so large that it paid about $15,000 a year net to its owner. One day this man was awakened with a sudden jolt. He had lost his entire business—lost it in one day. Seems impossible, doesn't it? It usually is. His case, however, was different. His business consisted of just one line. It was large as to income, but small in business units. He could attend to it in a few days, pocket the commission, and consume the balance of the year spending it. That business was nothing more than a "target risk." He had to work hard to sell the insurance in the beginning, and he had to work just as hard to keep it each year. Every insurance man in the vicinity made a fight for it, and one day some other fellow got it, and I suppose he is fighting just as hard now to keep it as he did to get it. The first man who handled this risk failed to build around it a sufficient number of small lines to keep him in business when the crash came; consequently, he is not now writing insurance.

This is, of course, an extreme case, but it typifies the probable result of an insurance business built on "target risks" alone. Contrast with it one consisting of numerous small lines. For instance, take a surety agent whose fidelity business in the majority of cases consists of individual bonds in favor of small houses employing a bookkeeper, a cashier and one or two clerks; or an employer who has fifty or even one hundred employees covered under a schedule or individual bonds. His is a real business.

Suppose you were in the market for a going insurance agency. Suppose further that two propositions were submitted to you, both showing the same income, and that one agency controlled a business consisting of one line, whereas the other consisted of numerous smaller lines. Which would you buy? The small one, of course! Why? Simply because you could lose a risk, or several, without losing your entire business.

Insurance agencies, it is true, are not usually bought and sold like other enterprises, but our hypothetical case above outlined illustrates the advisability of either having your business consist of numerous small lines, or building around your larger risks a number of smaller ones. An insurance business built upon small lines has great advantages over a purely target risk business. With small lines, you usually deal direct with the employer, who can give you the order to renew without referring

the matter to some one "higher up," and you not only get his decision directly and promptly, but your own personality enters into the transaction. He knows you, and would rather deal with you than with strangers.

Then, there is the advantage of securing renewals without competition. Competitors are not as likely to solicit your small lines as they are to go after your large ones. You can in most cases secure the small renewals. You get the order when you deliver the expiration notice. It is only necessary to show the employer the notice, and after ascertaining that the employee is still with him and the amount is not to be changed, tell him you will send him the continuation certificate. His mind, like all others, works along lines of least resistance. If you appear to do all the work—"make it easy" for him—he will usually let you go ahead. He does not want to be bothered, but he must be made to feel that he is being properly covered and taken care of. Your service will make him the judge of that.

Where, as is now usual, an employer holds a continuous bond, the securing of a renewal or continuation of such bond should be easier, as there is nothing to do but send him a bill when the premium is due. Do not send it before. If any change is to be made in the amount, etc., let him tell you about it then. If there are no changes to be made, you have again "made it easy" for him, and the renewal will stick. There are, of course, cases that must be handled differently. Your knowledge of your customers will enable you to decide upon the best method.

This article is not intended to belittle the importance to an insurance agency of having upon its books large lines, the so-called "target lines." They are nice things to have and are well worth working for, but not to the extent that the small risks should be entirely neglected because the big ones pay handsomely.

Statistics show that the average amount of life insurance carried by each person insured is only about $2,000, and this in spite of the fact that many men carry very large policies. While a life insurance agent has the advantage when he secures a large application, in that he is in no danger of losing it later because it usually renews itself, he, at the same time, measures his income by the number of one-thousand-dollar applications he can secure in a given time, and not from the fact that he might secure one big application in the same time.

Try to make the principal part of your business consist of small lines; at the same time, go vigorously after the large ones. Look upon the big risks, however, not as regular, but as an extra income. You will find that mixed lines of this kind will keep you from worrying about the future of your business.